No. 91-983

DEC 17 1991

OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1991

ALLSTATE INSURANCE COMPANY,
an Illinois Corporation,

Petitioner,

v.

SAMUEL F. FORTUNATO,
Commissioner of Insurance of
The State of New Jersey,

Respondent.

Petition For A Writ Of Certiorari To The Appellate Division Of The Superior Court Of The State Of New Jersey

APPENDIX, VOLUME II

DUANE C. QUAINI
(Counsel of Record)
WILLIAM T. BARKER
SONNENSCHEIN NATH & ROSENTHAL
8000 Sears Tower
Chicago, IL 60606
(312) 876-8000

Of Counsel:

RICHARD A. EPSTEIN
1111 East 60th Street
Chicago, IL 60637
(312) 702-9563

WILLIAM J. BRENNAN, III
SUZANNE M. MCSORLEY
SMITH, STRATTON, WISE,
HEHER & BRENNAN
600 College Road East
Princeton, NJ 08540
(609) 924-6000

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS OF APPENDIX

TABLE OF CONTENTS OF APPENDIX – Continued

TABLE OF CONTENTS OF APPENDIX – Continued

APPENDIX 8

February 8, 1991

BY HAND

The Honorable Samuel F. Fortunato
Commissioner of Insurance
New Jersey Department of Insurance
20 West State Street
CN 325
Trenton, New Jersey 08625-0325

Re: Request for Stay of January 24, 1991 Depopulation Order

Dear Commissioner Fortunato:

Please accept this letter, in lieu of a more formal brief, in support of the application of Allstate Insurance Company ("Allstate") for a stay pending appeal from the order you issued on January 24, 1991 assigning exposures to Allstate pursuant to the Voluntary Market Program. We have appended a copy of the Order, which Allstate received on January 29, as Exhibit 3 ("Depopulation Order") in the Affidavit and Exhibit Appendix submitted herewith.

Allstate has now filed a notice of appeal in the Appellate Division, with a request that the appeal be expedited. Pursuant to *R.* 2:9-7, Allstate asks that you stay the Depopulation Order pending disposition of that appeal or until you have acted upon pending requests by Allstate for increases (either interim or permanent) in its automobile insurance rates.[1]

---

[1] The rate relief currently requested by the Market Transition Facility ("MTF") is not adequate, standing alone, to

(Continued on following page)

Introduction

The Depopulation Order has numerous legal deficiencies on its face, some of which will be discussed below. But its most important flaw is its devastating and unconstitutional impact on Allstate if Allstate is required to comply without a sufficient adjustment to Allstate's rates and/or to the MTF rates Allstate would be permitted to charge for the policies issued pursuant to the required offers. Allstate's existing rates are inadequate even to support the costs of providing automobile insurance for its existing policyholders. Yet the Depopulation Order seeks to compel Allstate to issue over 32,000 additional policies at rates which are grossly inadequate to cover the costs of providing that insurance.[2] Because Allstate's present rates are inadequate for its existing business, that business cannot support the massive losses which would be suffered in connection with the business the Depopulation Order would compel Allstate to write.

(Continued from previous page)

prevent irreparable harm to Allstate; nor is less than the entire interim relief sought by Allstate. However, the requested stay could be reevaluated in light of any relief provided and any findings made in ruling on any of the pending rate requests.

[2] At present MTF rates, which are somewhat higher than Allstate rates, Allstate estimates an average loss of $634 on each car insured under these policies, so that the *additional* loss imposed by the Depopulation Order amounts to over $20 million (and perhaps as much as $26 million) annually. (Affidavit of Michael A. LaMonica ("LaMonica Aff."), appended hereto as Exhibit 1, ¶ 3.)

The Depopulation Order would thus effect a taking of Allstate's property without just compensation in violation of the United States and New Jersey constitutions and the insurance laws of New Jersey. Because neither the insurance laws nor the Depopulation Order provide any mechanism for recovery of the losses to be suffered if Allstate were to comply with that Order, Allstate would be irreparably harmed by compliance and the Order should be stayed pending an adjudication of its legality or a decision on Allstate's requests for permanent or interim rate relief.

Statement of Facts

As you know, the Department's 1989 study of automobile insurance profitability showed that automobile insurers operating in New Jersey (and Allstate in particular) had suffered massive operating losses for the period 1976-88.[3] For the years 1989-90, both the industry and Allstate suffered further aggregate operating losses.[4]

---

[3] A copy of the 1989 study is appended as Exhibit 4. Allstate's losses are further documented by its Annual Statements and rate filings covering this period, which are incorporated by reference.

[4] Allstate's more recent net losses are documented in the Direct Testimony of David R. Chernick ("Chernick Testimony"), submitted in the Allstate rate hearing now in progress, a copy of which is appended as Exhibit 5. As a result of these persistent operating deficits, Allstate has received no return for 15 years on the substantial capital which it has exposed to the risks of the New Jersey automobile insurance business and has actually lost roughly $37 million of that capital. (LaMonica Aff. ¶ 4) Had Allstate been able to realize

(Continued on following page)

Moreover, the losses reflected in that study understated the magnitude of the overall problem of rate inadequacy because they failed to take into account the even more massive operating losses of the JUA, as shown by its various filings (most notably those relating to imposition of RMEC), which are incorporated by reference.

The JUA's rates were so severely inadequate that, even with a subsidy from RMEC's and policy constants (currently totaling $222 for every insured vehicle in New Jersey),[5] the JUA incurred a deficit of over $3 billion. In part, this reflected the JUA's heavy concentration of business in territories where rates were especially inadequate due to territorial rate capping imposed by N.J.S.A. 17:29A-36.[6] As with all other insurers, the JUA rates in the capped territories were far more severely inadequate than the average for JUA rates.

(Continued from previous page)

the 3.5% operating profit which is presumptively proper under Insurance Department regulations (and Allstate contends that a higher rate is actually required under current conditions), it would have earned a total of $143 million for that period, a result prevented by the consistent refusal of your predecessors to approve adequate rates. (LaMonica Aff. ¶ 4) Thus, rate inadequacy for this period produced confiscation of approximately $180 million of Allstate's property.

[5] With approximately 4,300,000 New Jersey vehicles currently insured, RMEC's and policy constants currently provide a subsidy to the JUA rates of almost $1 billion annually.

[6] That statute limits the average rate for any territory to 135% of the filer's statewide average rate when, as Special Deputy Commissioner David Grubb observed in 1989, claims per car in the highest-rated territory ranged from 155% to 306% of the statewide average (depending on which coverage was considered). Grubb, *Solving the Auto Insurance Crisis in New Jersey*, 20. (A copy of this report is appended as Exhibit 11.)

The JUA's rates became those of the MTF, but the MTF will not be entitled to either RMEC's or policy constants after April 1. Fair Automobile Insurance Reform Act of 1990 ("FAIRA"), P.L. 1990, c.8, § 17 (to be codified as N.J.S.A. 17:33B-6). Although the MTF has recently obtained two independent actuarial studies indicating that its rates must increase an average of roughly 60% to cover the costs of insuring its current population, it has filed for an increase averaging only 28%.[7] By filing for a rate increase substantially less than that necessary to cover the costs of insuring its population, the MTF will impose the remainder of those costs (amounting to hundreds of millions of dollars) on Allstate and other private insurers, which are statutorily obligated to absorb the MTF's losses.[8] FAIRA, § 88 (to be codified as N.J.S.A.

---

[7] Copies of those studies are annexed to the Chernick Testimony as Attachment G. The MTF rate filing is appended hereto as Exhibit 6. The studies show that the indicated increase of roughly 60% would allow the JUA to realize neither a profit nor a loss on the policies to be written in the year beginning April 1, 1991, but would leave voluntary-market insurers to absorb a loss of roughly $330 million dollars from policies the MTF has written or will write at JUA rates during the period October 1, 1990 through March 31, 1991. Were the MTF to receive no increase at all, it would suffer net losses for its entire two years of underwriting totalling over $1 billion, all of which would have to be covered by voluntary-market insurers.

[8] According to a memo to you from one of your deputies (copy appended as Exhibit 7), the MTF has limited its request to 28% in order to avoid subjecting "clean" risks to any increase other than the 9.4% flex-rate increase necessary to cover inflationary cost increases. Thus, the proposed increase does nothing to ameliorate the pre-existing gross inadequacy of MTF rates for such risks.

17:33B-11). Moreover, even were the MTF given the 60% indicated average increase (which it has not requested), the MTF rates for the capped territories would remain totally inadequate to cover the costs of insuring drivers in those territories, and involuntary depopulation assignments are made overwhelmingly from the capped territories.

Even had Allstate's rates been adequate for the risks it insured before FAIRA became law, and Allstate submits they were not, FAIRA imposed massive additional costs which were not provided for in those rates. In particular, the depopulation of the JUA requires Allstate to provide insurance at either its own existing rates or those of the JUA/MTF (but without the billion-dollar annual subsidy to the JUA/MTF rates previously provided by RMEC's and policy constants). Yet even with the subsidy provided by RMEC's and policy constants, the JUA rates (which were higher than Allstate's rates) could not cover the costs of insuring JUA policyholders, ultimately producing a deficit of over $3 billion. Moreover, by accelerating the depopulation process, FAIRA increased the costs currently imposed by that process.[9] FAIRA also imposed taxes and surcharges to cover the lion's share of the

---

[9] An amendment to the JUA Plan of Operation which you first proposed on October 3, 1990 altered the allocation of depopulation quotas among insurers in a way which retroactively increased Allstate's quota by 24,134 exposures. This retroactive change in the formula substantially increased the costs imposed on Allstate.

multi-billion dollar JUA deficit and apparently forbade insurers to recover those taxes and surcharges from policyholders, although you now take the position that they may be recoverable through rate filings in certain circumstances.

Allstate has pending two rate filings (copies appended as Exhibits 12 and 13) which both document the inadequacy of its rates to absorb the enormous extra costs imposed by FAIRA and seek the increases necessary to support those costs. Both are now the subject of what seem likely to be protracted proceedings before permanent relief can be provided. Accordingly, Allstate has filed requests (copies appended as Exhibits 8 and 9) that it be permitted to implement the proposed increases on an interim basis, with the proceeds to be escrowed for distribution in accordance with the ultimate findings in those proceedings. Only if full rate relief (on at least an interim basis) is provided could Allstate's rates be even close to adequate to support the costs of depopulation assignments and the other FAIRA costs.[10]

Absent a rate increase, Allstate anticipates an automobile insurance operating loss for policies written in 1991 of 35% of the premiums earned, an amount estimated at $111,000,000. (LaMonica Aff. ¶ 5) Of this loss, over $20,000,000 would be produced by compliance with the Depopulation Order. (LaMonica Aff. ¶ 3) Indeed,

---

[10] For reasons explained in the Chernick Testimony, developments since Allstate made its rate filings indicate that the costs imposed by FAIRA will be even greater than Allstate anticipated at the time it made those filings, so that the increases requested would not in fact be sufficient to support the FAIRA costs. Allstate does not seek any relief at the present time based on the additional costs not anticipated by its pending filings.

even were one to consider all of Allstate's insurance business in New Jersey, rather than just its automobile insurance business, Allstate anticipates a substantial operating loss for 1991 absent automobile insurance rate increases.[11] Thus, forced issuance of policies pursuant to the Depopulation Order without first providing adequate rate relief is a naked and uncompensated transfer of Allstate's property to those it is required to insure, in violation of the New Jersey insurance laws and the constitutions of the United States and New Jersey.[12]

In light of FAIRA's apparent prohibition on recovery of the taxes and assessments it imposed, Allstate acted diligently by applying for rate relief relating to those taxes and assessments in August, promptly after you announced the position that they might be recoverable in

---

[11] (LaMonica Aff. ¶ 6) Allstate does not believe that it is proper to consider other lines in pricing automobile insurance and provides this information solely to show that it would make no difference here even were that proper.

[12] Allstate is not even free to avoid this appropriation of its assets by ceasing to write automobile insurance or even by withdrawing entirely from New Jersey. You have adopted a policy of requiring any insurer seeking to withdraw from the New Jersey automobile insurance market to continue writing automobile insurance for several years and to substantially expand that business and increase its losses by accepting involuntary assignments of inadequately rated JUA/MTF business. *In Re Plan of Orderly Withdrawal from New Jersey of Twin City Fire Insurance Co.*, No. A90-151 (N.J. Ins. Dept. Aug. 14, 1990) (copy appended as Exhibit 10). Thus, Allstate has been conscripted to provide automobile insurance and is unable to escape from the burden of confiscatory rates.

some circumstances. (LaMonica Aff. ¶ 7) You have also indicated, in the litigation relating to that filing, that no action could have been taken on such a filing, even had it been made earlier, because you had not yet developed the standards applicable to such filings.

Allstate also acted diligently in making its October filing promptly after it became possible to estimate the rate levels to be required in light of FAIRA and related developments, including the retroactive change in the formula for allocating depopulation obligations. (LaMonica Aff. ¶ 7) That filing was made in time to have permitted action by you, at least on an interim basis, prior to issuance of depopulation assignments.

The Depopulation Order heaps upon insurers enormous losses from the JUA (aggravated by the removal of the billion dollar annual subsidy formerly provided by RMEC's and policy constants). Even with the RMEC's and policy constants, the JUA built a multi-billion dollar deficit in just seven years because of its gargantuan rate inadequacy. The Depopulation Order exacerbates the burden on insurers because it does not merely make assignments from a representative cross-section of the JUA. Rather, it makes assignments preferentially from rating territories with the lowest percentages of vehicles insured in the voluntary market, a disturbed assignment method nowhere authorized by the statute. In general, these territories have low voluntary market coverage precisely because the territorial rate capping imposed by N.J.S.A. 17:29A-36 renders the rates for those territories systematically inadequate.

By assigning insureds overwhelmingly from these territories, the Depopulation Order disproportionately assigns Allstate insureds likely to produce the highest net losses when the rates Allstate is permitted to charge those insureds are compared with the costs likely to be incurred in insuring them. This punitive method of making depopulation assignments from the most severely underpriced insureds in the JUA instead of from an average segment of its population is one of the increased FAIRA costs which Allstate did not anticipate even at the time it made its October rate filing. This change nearly tripled the previously estimated costs associated with the assignments which are made by the Depopulation Order. (Chernick Testimony 12-113)

As explained below, Allstate also contends that the Depopulation Order is facially flawed in a number of other respects. Specifically, Allstate contends that (1) the Depopulation Order is contrary to FAIRA and to the JUA Plan of Depopulation insofar as it purports to require Allstate to offer insurance to those who are not eligible persons entitled to insurance outside the assigned risk plan or the MTF; (2) the Order is contrary to law insofar as it purports to forbid Allstate to non-renew six-month policies which it has a statutory right to non-renew and insofar as it prohibits implementation at the time six-month policies are renewed of rate increases approved during the life of those policies; (3) the Depopulation Order exceeds your statutory authority by requiring Allstate to make offers to 25% more JUA insureds than its depopulation shortfall, even if it has already written enough policies to cover that shortfall; and (4) the Depopulation Order is contrary to law insofar as it

requires Allstate to write the assigned policies through the insureds' former JUA producers.

The need for a stay does not arise solely from the substantive defects of the Depopulation Order, for that Order also sets an extremely burdensome schedule. The Order requires Allstate to begin making offers of insurance on March 1 for policy periods to begin April 1 and thereafter. Even were there no other problems with the Order, this creates enormous administrative difficulties.

To begin with, Allstate did not even receive the Depopulation Order until January 29. Further, the Depopulation Order does not contemplate that Allstate will receive information regarding its actual assignments until at least February 14, and perhaps not until much later. *See* Mandatory Depopulation Assignment Plan ("Assignment Plan"), attached to and incorporated in Depopulation Order, ¶ 19.

Moreover, it will be extremely difficult for Allstate, within 30 days of its January 29 receipt of the Depopulation Order, to analyze data regarding Allstate's ability to make offers to its insureds, design a system to collate that data, program and format that data onto its computers, test the accuracy of the programming and produce finished offers and related materials. (Affidavit of Douglas W. Reynolds, appended hereto as Exhibit 2, ¶ 6) This problem is exacerbated by the fact that Equifax, which is to provide Allstate with much of the necessary information to complete its offer requirements, has produced a test tape as to which much key information is either missing or seemingly inaccurate. *Id.* ¶ 7. Finally, the Order does not give Allstate sufficient time to develop

adequate completed coverage selection forms, to negotiate contracts with adequately trained producers with whom it is being forced to deal or to create a compliance system that will ensure the development of accurate policyholder information in the future. *Id.* ¶¶ 8-10.

Argument

Under New Jersey law, a stay or injunction maintaining the status quo between the parties pending determination of litigation on the merits of a dispute should be ordered if the following criteria are met:

1. the subject matter of the controversy will otherwise substantially change during the pendency of the litigation, thus causing irreparable harm to the moving party;
2. the harm or loss to the opposing party will be minimal; and
3. a substantial question as to the merits has been raised, creating a reasonable probability of success on the merits.

See, e.g., Crowe v. DeGioia, 90 N.J. 126, 132-34, 447 A.2d 173, 176-77 (1982); *Naylor v. Harkins*, 11 N.J. 435, 446, 94 A.2d 824, 828 (1952); *Christiansen v. Local 680 of Milkdrivers*, 127 N.J. Eq. 215, 219-20, 12 A.2d 170, 172 (1939).

Imposition of a stay is particularly appropriate where, in the absence of such relief, the status quo will irreparably change. *See, e.g., Naylor v. Harkins, supra*, 11 N.J. at 446; *Christiansen v. Local 680 of Milkdrivers, supra*, 127 N.J. Eq. at 219. Mere doubt as to the validity of a claim is not an adequate basis upon which to deny a stay. *See, e.g., Crowe v. DeGioia, supra*, 90 N.J. at 133.

1. Irreparable Harm to Allstate Absent a Stay.

The Depopulation Order would, if Allstate is correct, produce irreparable harm in several ways. The first of these is that, without adequate rates, the Order would confiscate Allstate's assets each time it forced Allstate to issue a policy. If, pursuant to the Depopulation Order, Allstate is forced to issue policies at current rates (either its own or those of the MTF), it will be unable to alter those rates for one year after the policy's inception. Assignment Plan, ¶ 21. Allstate also could never recover the losses suffered pursuant to those rates in future rates. *Petition of Elizabethtown Water Co.*, 107 N.J. 440, 453-55, 527 A.2d 354, 363-64 (1987). Thus, issuance of policies at inadequate rates necessarily causes irrecoverable losses, thereby effecting a blatant and unconstitutional seizure of Allstate's assets.

A second way in which the Depopulation Order causes irreparable harm relates to the number and identity of those Allstate must offer to insure. Some of these are statutorily ineligible to procure insurance in the voluntary market because they present too high a risk to be insurable in that market or are similarly ineligible for involuntary assignments under your own depopulation plan. *See* FAIRA, § 25; New Jersey Automobile Full Insurance Underwriting Association, Plan of Operation ("JUA Plan"), Operating Principles, Section 13, ¶2. Others, while eligible for voluntary-market insurance, are systematically drawn from territories whose rates are the most inadequate and in numbers which Allstate contends far exceed any proper depopulation quota. Put differently, while FAIRA requires only a general JUA depopulation,

the Order goes much further in requiring a specific depopulation by territories.

If Allstate is forced to insure ineligible insureds, or excessive numbers of the most grossly underpriced insureds, it will be irreparably injured because it will be unable to refuse renewal to such insureds except in the most narrowly limited of circumstances. *See* N.J.S.A. 39:6A-3, 17:29C-7.1; N.J.A.C. § 11:8.3-8.4. Accordingly, in the absence of a stay, Allstate will be unable to take full advantage of any relief the Appellate Division might ultimately grant on the merits.

Nor, absent a stay, could Allstate avoid harm by refusing to comply with the Depopulation Order, for that would subject it to heavy penalties, at least if the Order is found valid.[13] It is fundamentally unfair to subject a business to severe penalties for failure to comply with a debatable administrative order which it cannot effectively challenge except by non-compliance. *In Re Kimber Petroleum Co.*, 110 N.J. 69, 539 A.2d 1181 (1988). Thus, a stay is appropriate where, as here, the doubtful validity of the order threatens irreparable harm regardless of whether the party subject to the order complies or resists.

---

[13] If the Order is unconstitutional or otherwise invalid, its enforcement may properly be enjoined. *Ex Parte Young*, 209 U.S. 123 (1908); *Guarantee National Ins. Co. v. Gates*, 916 F.2d 508 (9th Cir. 1990). Imposition of penalties would similarly be improper in such a case.

2. Absence of any Irreparable Harm Resulting From a Stay.

In contrast to the irreparable harm that will be suffered by Allstate if the Depopulation Order is not stayed, there will be *no harm* if a stay is granted. A stay will simply maintain the status quo for the brief period it will take the Appellate Division to consider the merits of Allstate's appeal or for you to act (at least on an interim basis) on Allstate's rate applications.

No New Jersey insured will be forced to go without coverage if a stay is granted. Rather, the insureds assigned to Allstate will continue to be insured by the MTF. And the Department will always be able to transfer those insureds to Allstate if the Depopulation Order is eventually judicially affirmed.

Consequently, any balancing of the harms weighs heavily in favor of Allstate. That is particularly true since, in the absence of a stay, Allstate will be forced to make offers to its assigned insureds beginning March 1, 1991 – before any appeal from the Depopulation Order can be decided.

3. Allstate's Likelihood of Success on the Merits.

a. Unconstitutional Confiscation

The due process clauses of the United States and New Jersey Constitutions require that New Jersey allow businesses the opportunity to earn a fair rate of return on their activities in the State. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 223, 394 A.2d 65, 70 (1978), *appeal*

dismissed for want of a substantial federal question, 440 U.S. 978 (1979). This means that regulated rates must be sufficient not only to cover costs and expenses, but also to yield a profit "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted). "[T]he return should be one which is commensurate with returns on investments in other enterprises having comparable risks." *Hutton Park Gardens v. West Orange Town Council,* 68 N.J. 543, 570, 350 A.2d 1, 14-15 (1975). Even apart from constitutional considerations, the legislature has directed that insurers be permitted a fair rate of return. N.J.S.A. 17:29A-4; FAIRA, § 2(g). To force insurers to suffer massive and unrecoverable losses, as the Depopulation Order would do here, is thus to accomplish an unconstitutional and unlawful confiscation of property.

b. Insurance of Ineligible Persons

FAIRA, among other things, establishes a framework for the placement of individuals previously insured by the JUA into the voluntary insurance market or the MTF. N.J.S.A. 17:30E-14. The MTF itself is to insure successively smaller fractions of the market, with its insureds also being moved progressively into the voluntary market, until the MTF insures no more than 10% of all New Jersey vehicles. N.J.S.A. 17:29D-1. At that point, an Assigned Risk Plan is to take over the function of providing insurance to those not insured in the voluntary market. *Id.* However, FAIRA makes it clear that only

certain categories of JUA insureds, known as "eligible persons," are intended to be insured in the voluntary market. FAIRA, § 25 (to be codified as N.J.S.A. 17:33B-13). Others are to be insured through the Assigned Risk Plan once MTF depopulation is complete. Since the whole purpose of depopulation is to move into the voluntary market those insureds who ought not to be relegated to the involuntary market, it would be contrary to the statutory scheme for those who are not eligible persons to be removed from the MTF by assignment to voluntary market insurers.

Eligible persons are statutorily defined to exclude several categories of drivers – those who: (1) in the past three years, have committed a motor vehicle offense; (2) have had their driver's license suspended or revoked; (3) in the past five years, have been involved in insurance fraud; (4) within the past two years, have had a policy cancelled for non-payment of premium; (5) have failed to obtain membership in a club or group, membership in which is a uniform prerequisite to insurance coverage; (6) have had an excessive number of vehicle "points" in the past three years; and (7) possess other risk factors to be determined by the Commissioner. *Id.*

Pursuant to statute, the JUA Plan of Operation specifies the mechanism for the contemplated depopulation of the JUA. JUA Plan, Section 13. That plan further limits insureds eligible for the voluntary market to those who have not been convicted of two or more moving violations, not received four or more vehicle "points," and not had one or more at-fault accidents. *Id.* ¶2. If an individual does not meet these criteria, he cannot be assigned to

insurers who have not met their quota of JUA depopulation business. *Id.*

The Depopulation Order ignores the eligibility standards set by the legislature in FAIRA. Instead, it provides that, in meeting the prescribed depopulation quota, Allstate is to be randomly assigned insureds from the JUA pool – regardless of whether those individuals meet either the JUA Plan eligibility standards or those set by FAIRA for insurability in the voluntary market. *See* Assignment Plan, ¶4. Indeed, the Order expressly prohibits Allstate from failing to accept an assignment where the prospective insured has failed to gain membership in a club, membership in which is a precondition to the writing of insurance, even though that is one of the express eligibility standards set forth in FAIRA.[14] Depopulation Order, 5.

New Jersey state agencies, including the Insurance Department, may not issue orders that are substantively inconsistent with the relevant enabling statutes. *See, e.g., Smith v. Director, Division of Taxation*, 108 N.J. 19, 26, 527 A.2d 843, 846 (1987); *Pascucci v. Vagott*, 71 N.J. 40, 49-51, 362 A.2d 566, 571-72 (1976); *In the Matter of Blue Cross & Blue Shield*, 239 N.J. Super. 434, 452, 571 A.2d 985, 994 (App. Div. 1990). Here, the Depopulation Order conflicts on its face with FAIRA, by permitting completely random assignments to Allstate of insureds from the JUA pool – without regard to their eligibility for voluntary market

[14] Allstate has no such membership requirements, but this provision is illustrative of the Depopulation Order's patent conflict with FAIRA.

status. It also conflicts with the terms of the JUA Plan established pursuant to statutory authority.

c. One Year Prohibition of Non-Renewal and of Implementation of Approved Rate Increases.

One purpose of FAIRA is to allow eligible persons to obtain insurance in the voluntary market. The Depopulation Order, however, goes much further. That Order requires Allstate to insure its assignments at the initial rate for a full year, regardless of whether any rate increase has been approved by you during that period. *See* Depopulation Order, 4-5.

Normally, Allstate, which issues policies on a six-month basis, would be able (and, indeed, required) to renew its voluntary policies during the second six months of a one-year period at any increased rate that may be in force at the time. N.J.S.A. 17:29A-6. By prohibiting Allstate from doing that here, you are forcing Allstate to provide coverage to its JUA assignments on a more favorable basis than to its voluntary market insureds. That is wholly inconsistent with FAIRA, which requires JUA insureds to be treated equally with – not more favorably than – voluntary market insureds. It is also inconsistent with the rate regulatory statutes, which both permit and require insurers to charge the rates in effect at the time the policy is issued.

Another impermissible inconsistency between the Depopulation Order and the New Jersey insurance statutes is created by the Order's non-renewal limitation. While the relevant statutes allow for non-renewal of insurance policies in certain instances other than for non-

payment of premium (*see* N.J.S.A. 39:6A-3 and 17:29C-7.1), the Depopulation Order arbitrarily limits Allstate's non-renewal rights, for a full year, to *only* situations where there has been non-payment of premium (Depopulation Order, 5). In other words, even if Allstate would have a *statutory right* to terminate a policy, the Order takes away that right. Once more, such an inconsistency between the Depopulation Order and the relevant statutes is legally unsupportable.

d. Excessive Offers Required

Further, the Depopulation Order requires Allstate to make offers to 25% *more* JUA insureds than its quota, *even if it has already insured enough JUA insureds to meet its quota*. Assignment Plan, ¶¶3, 8. Yet, FAIRA requires only that New Jersey insurers accept *up to* their apportionment share of former JUA business; nowhere in that statute is the Commissioner authorized to force insurers to accept *more* than their share. *See* N.J.S.A. 17:30E-14(b), (c). The requirement of 25% more offers than Allstate's quota is fatally inconsistent with the relevant enabling statute.

e. Requirement To Write Through JUA Producers

Moreover, the Depopulation Order requires Allstate to write and service former JUA business through any randomly selected JUA producer who provides such business. *See* Assignment Plan, ¶4. However, FAIRA explicitly provides that the "procedures governing the increase in market volume shall . . . neither prohibit nor require member companies [such as Allstate] to write

association business through association producers of record. . . . " *See* N.J.S.A. 17:30E-14(i)(3).

The clear import of the relevant enabling statute is that New Jersey insurers are *not* to be required to deal with any particular producer with respect to JUA business. Of course, the entire purpose of the Depopulation Order is to transfer JUA business to Allstate. Accordingly, that Order, in contravention of FAIRA, plainly *requires* Allstate to deal with JUA producers with respect to JUA business.

By requiring Allstate to deal with particular producers, the Order forces Allstate to in effect employ individuals without regard to their background or credibility. Those individuals can hardly be expected to have the type of commitment to Allstate necessary to form a productive working relationship. That is of particular concern to Allstate because its reputation is, in part, determined by the acts of its agents. Moreover, to the extent these JUA producers breach their contracts with Allstate, or commit other wrongs, Allstate will not be able to terminate them without your approval.

Conclusion

For the foregoing reasons, Allstate is entitled to a stay of the Department's Depopulation Order, pending review of that Order by the Appellate Division or a decision (at least on an interim basis) on Allstate's rate applications. As you are aware, the Depopulation Order requires Allstate to begin compliance by March 1, 1991. Accordingly, if no decision is reached on Allstate's stay motion by, at the very latest, the end of business on

February 19, 1991, Allstate will be deprived of its right to present its stay request before the Appellate Division in sufficient time to obtain full relief. Therefore, Allstate respectfully requests a ruling on its motion for a stay herein prior to that date.

Respectfully yours,

/s/ Suzanne M. McSorley
Suzanne M. McSorley

cc: Douglas S. Eakeley

Of Counsel:

Duane C. Quaini
William T. Barker
Sonnenschein Nath & Rosenthal
8000 Sears Tower
Chicago, Illinois 60606
(312) 876-8000

APPENDIX 9

SMITH STRATTON WISE HEHER & BRENNAN
600 College Road East
Princeton, New Jersey 08540
(609) 924-6000

SONNENSCHEIN NATH & ROSENTHAL
8000 Sears Tower
Chicago, IL 60606
(312) 876-8000

Attorneys for Allstate Insurance Company

IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO ALLSTATE INSURANCE COMPANY, A MEMBER COMPANY OF THE NEW JERSEY AUTOMOBILE FULL INSURANCE UNDERWRITING ASSOCIATION AND THE MARKET TRANSITION FACILITY OF NEW JERSEY, PURSUANT TO THE VOLUNTARY MARKET PROGRAM 1991-111	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2631-90T5F NOTICE OF APPEAL On Appeal from: Final Order of the Department of Insurance FILED FEB 8 1991

TO: THE HONORABLE JUDGES OF THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION

HON. SAMUEL F. FORTUNATO
Commissioner of Insurance
20 West State Street
Trenton, New Jersey

DOUGLAS S. EAKELEY
Acting Attorney General of the State
New Jersey
Richard J. Hughes Justice Complex
CN 080
Trenton, NJ 08625-080

PLEASE TAKE NOTICE that Allstate Insurance Company ("Allstate") appeals to the Superior Court of New Jersey, Appellate Division, from an Order of the Commissioner of Insurance, dated January 24, 1991 ("Order"), which action is a final agency decision pursuant to *R.* 2:2-3, for the following reasons:

(1) the Order's requirement that Allstate supply private passenger automobile coverage to any Joint Underwriting Association ("JUA") insured assigned to Allstate, regardless of whether that person is an "eligible person" under the relevant statutory provision P.L. 1990, c. 8, § 25 (to be codified at N.J.S.A. 17:33B-13) is contrary to law;

(2) the Order's requirement that Allstate write and service policies through any JUA producer is contrary to law (N.J.S.A. 17:30E-14(i)(3));

(3) the Commissioner has retroactively altered the formula used in determining Allstate's quota requirements for acceptance as voluntary business of JUA insureds, which alteration prejudicially impacts Allstate;

(4) the Order requires Allstate to make offers to 25% more insureds than its quota, however that quota is calculated;

(5) the Order impermissibly forces Allstate to accept insurance risks for which the currently authorized New Jersey rates are grossly inadequate;

(6) the Commissioner may, for a full year with respect to former JUA policyholders assigned to Allstate, limit Allstate's statutory right (*see* N.J.S.A. 39:6A-3 and 17:29C-7.1) of non-renewal;

(7) the Order impermissibly prevents Allstate from complying with its normal voluntary market practice of renewing automobile insurance policies every six months at the rate level then authorized by New Jersey law;

(8) the Order is arbitrary and capricious for all of the above reasons and because: (a) the Order requires Allstate to twice undergo the substantial cost of providing the assigned policyholder with a Coverage Selection Form and Buyer's Guide, even though the relevant statute requires only one such provision; (b) the Order takes away Allstate's right to use any of its own voluntary business practices, with respect to assigned policyholders, for a full year; (c) the Order requires Allstate to begin compliance by March 1, 1991, even though such a start-date for compliance is impractical; (d) the Order requires Allstate to pay numerous costs for the servicing and administration of the depopulation plan that are not required by the relevant enabling statutes; and (e) the Order requires Allstate to begin offering coverage to assigned exposures by March 1, 1991,

even though it does not provide for Allstate to receive information regarding its assignments until some point between March 15 and March 20, 1991; and

(9) the Order violates principles of fundamental fairness.

A copy of the Order appealed from is attached hereto as Exhibit A.

Dated: Princeton, NJ
February 8, 1991

SMITH, STRATTON, WISE,
HEHER & BRENNAN
Attorneys for
Allstate Insurance Company

By: Suzanne M. McSorley
Suzanne M. McSorley

Of Counsel:

Duane C. Quaini, Esq.
Jeffrey P. Lennard, Esq.
William T. Barker, Esq.
SONNENSCHEIN NATH & ROSENTHAL
8000 Sears Tower
Chicago, IL 60606

(312) 876-8000

Exhibit A

1. Whether the Depopulation Order's requirement that Allstate supply private passenger automobile coverage to any JUA insured assigned to Allstate, regardless of whether that person is an "eligible person" under the

relevant statutory provision, P.L. 1990, c. 8, § 25, (to be codified at N.J.S.A. 17:33B-13), is contrary to law.

2. Whether the Depopulation Order's requirement that Allstate write and service policies through the JUA producer is contrary to law. (N.J.S.A. 17:30E-14(i)(3).)

3. Whether the Commissioner may retroactively alter the formula used in determining Allstate's quota requirements for acceptance as voluntary business of JUA insureds when such alteration prejudicially impacts Allstate.

4. Whether the Commissioner may require Allstate to make offers to 25% more insureds than its quota, however that quota is calculated.

5. Whether the Depopulation Order impermissibly forces Allstate to accept insurance risks for which the currently authorized New Jersey rates are grossly inadequate.

6. Whether the Commissioner may, for a full year with respect to former JUA policyholders assigned to Allstate, limit Allstate's statutory right (*see* N.J.S.A. 39:6A-3 and 17:29C-7.1) of non-renewal.

7. Whether the Depopulation Order impermissibly prevents Allstate from complying with its normal voluntary market practice of renewing automobile insurance policies every six months at the rate level then authorized by New Jersey law.

8. Whether the Commissioner's Depopulation Order is arbitrary and capricious for all of the above reasons and because: (a) the Order requires Allstate to twice undergo the substantial cost of providing the

assigned policyholder with a Coverage Selection Form and Buyer's Guide, even though the relevant statute requires only one such provision; (b) the Order takes away Allstate's right to use any of its own voluntary business practices, with respect to assigned policyholders, for a full year; (c) the Order requires Allstate to begin compliance by March 1, 1991, even though such a start-date for compliance is impractical; (d) the Order requires Allstate to pay numerous costs for the servicing and administration of the depopulation plan that are not required by the relevant enabling statutes; and (e) the Order requires Allstate to begin offering coverage to assigned exposures by March 1, 1991, even though it does not provide for Allstate to receive information regarding its assignments until some point between March 15 and March 20, 1991.

9. Whether the Depopulation Order violates principles of fundamental fairness.

Exhibit B

1. The precise matter in controversy here is not the subject of any other action pending or about to [sic] brought in this court.

Allstate and the Commissioner Samuel F. Fortunato and the Department of Insurance, however, are parties to several pending matters regarding private passenger automobile insurance in the State of New Jersey, including: *Fortunato v. Aetna Casualty & Surety, et al.*, an administrative action in the State of New Jersey, Department of Insurance (filed 2/20/90); *Allstate Insurance Company v. James J. Florio*, Superior Court of New Jersey, Chancery

Division, Docket No. C-90-0118; *State Farm Mutual Automobile Insurance Company and Allstate Insurance Company v. Samuel Fortunato, et al.*, Supreme Court of New Jersey, Docket No. 32,789; *In the Matter of the Commissioner of Insurance's Certification of Amendments to the New Jersey Automobile Full Insurance Underwriting Association Plan of Operation*, Superior Court, Appellate Division, Docket No. A-5514-89T1; *In the Matter of State of New Jersey, Department of Insurance Order Nos. A89-120 and A89-171 and the Adoption of N.J.A.C. 11:3-16 and N.J.A.C. 11:3-18*, Superior Court of New Jersey, Appellate Division, Docket No. A-5324-88T1; *In the Matter of State of New Jersey, Department of Insurance, N.J.A.C. 11:3-20.1, et seq. and N.J.A.C. 11:3-20A.1*, Superior Court of New Jersey, Appellate Division, Docket No. A-1401-89T1; and *Allstate Insurance Company v. Fortunato, et al.*, Superior Court of New Jersey, Chancery Division, Mercer County, Docket No. C90-0189, on cross-motions for leave to appeal to the Appellate Division, Docket No. AM-585-90-T2.

APPENDIX 10

IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO ALLSTATE INSURANCE COMPANY	)	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2631-90T5F
and	)	
IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO THE AETNA CASUALTY AND SURETY COMPANY	)	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2618-90T5F
and	)	
IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO COLONIAL PENN INSURANCE COMPANY,	)	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2783-90

BRIEF OF APPELLANT
ALLSTATE INSURANCE COMPANY

Of Counsel &
On the Brief:

William J. Brennan, III
Suzanne M. McSorley

SMITH, STRATTON, WISE,
HEHER & BRENNAN
600 College Road East
Princeton, New Jersey 08540
(609) 924-6000
Attorneys for Appellant
Allstate Insurance Company

Of Counsel &
On the Brief:

Duane C. Quaini
William T. Barker
Jeffrey P. Lennard
Steven M. Levy

SONNENSCHEIN NATH &
ROSENTHAL
8000 Sears Tower
P. O. Box 932
Chicago, Illinois 60606
(312) 876-8000
Attorneys for Appellant
Allstate Insurance Company

TABLE OF CONTENTS

* * *

STATEMENT OF FACTS

New Jersey's High Cost and Underfunded Automobile Insurance System

In 1972, an Automobile Insurance Study Commission proposed the No Fault Act, intending to advance a "reparation objective" of providing prompt benefits to all accident victims and a "cost objective" of reducing or stabilizing automobile insurance prices. Automobile Insurance Study Commission, *Report to Governor and the Legislature, Reparation Reform for New Jersey Motorists*, 7 (1971).

To reduce or stabilize automobile insurance prices while providing compensation for all accident victims (including those whose injuries formerly went uncompensated) would have required that the new system balance the two objectives, either by curtailing some tort recoveries or moving cases out of the lawyer-intensive tort system. However, the No-Fault Act substantially increased compensation for medical bills and other economic losses while doing little to reduce the existing costs of the tort system, eliminating only

cases in which the accident victim incurred less than $200 in medical expenses. Despite this creation of a *more* costly system, the No-Fault Act responded to the public demand for lower insurance premiums by mandating an artificial 15% *reduction* in automobile insurance premiums. *N.J.S.A.* 39:6A-18.

The resulting high-cost system has been a continuing source of public dissatisfaction. There were numerous legislative efforts to "patch up" the system, but they seldom addressed the expensive benefit package at the heart of the problem. Governor Kean made the point in 1988:

> The 'no fault' system adopted in 1972 is grossly out of balance. The implicit promise of any 'no fault' system is prompt payment of medical bills without regard to fault in exchange for a significant limitation on frivolous lawsuits for non-economic damages, such as pain and suffering. This system has never been implemented in New Jersey. While we supposedly enacted a 'no fault' system in 1972, this system maintained the old fault system through its adoption of an unrealistically low $200 monetary obstacle to litigation. The inevitable result was a more expensive system, as we simply placed a costly new layer on the existing fault system.

Governor's Reconsideration and Recommendation Statement to Senate No. 2637 – L. 1988 c. 119.

In the wake of the 1988 amendments, Special Deputy Insurance Commissioner David N. Grubb undertook a further study of the New Jersey automobile insurance system and produced a report entitled *Solving the Auto Insurance Crisis in New Jersey* (the "Grubb Report"). Among his conclusions were the following (Al.a 54A-55A):

> Auto insurance premiums are high in New Jersey because of the state's high accident frequency (44% higher than the national average) and the state's unbalanced no-fault law. *The law is unbalanced because the lawsuit limitation does not reduce bodily injury liability premiums enough to offset the costs of mandated PIP medical benefits.*
>
> * * *
>
> In 1988, the state adopted a verbal threshold as the standard auto policy, and now has one of the four most effective lawsuit limitations. The verbal threshold will save the typical motorists with the standard policy approximately $100 per car as compared to the unlimited right to sue. *However, the no-fault law remains unbalanced because New Jersey mandates the most expensive package of no-fault benefits, and the actual cost of these benefits averages about $200 per car.*

While New Jersey officials have been unwilling to reduce the costs of the no-fault system enough to bring it into balance, they have not been willing to impose the entire cost of that system on the voting public. As Deputy Commissioner Grubb succinctly put it (ALa 56A):

> Since 1973, New Jersey has used tight controls on auto rates to avoid paying the actual cost of the state's high accident rate and unbalanced no-fault system. As a result, the voluntary market has been unprofitable, and the residual market (ie., the JUA) has grown to almost half of the state's motorists.

This general point is confirmed by an *Insurance Profitability Report* published by the New Jersey Department of Insurance in November, 1989, which found that (ALa 47A) (emphasis added):

> although private passenger auto has been a profitable insurance line nationally, the *industry* generated a 2.8 percent operating loss, or $521 million, in New Jersey over a 13-year period ending in 1988.
>
> Since 1976, insurers have lost money on private passenger auto in New Jersey in 10 out of 13 years.
>
> * * *
>
> In fact, over the 13-year period, operating losses on auto insurance have been more severe in New Jersey than in any other state.

The Rise and Fall of the JUA

Because the No-Fault Act required all motorists to maintain insurance, some mechanism was necessary to provide insurance to those unable to procure it in the voluntary market.[4] This was provided by authorizing the Commissioner to organize a plan through which such motorists could be assigned to insurers which would be required to insure them at rates established by the plan. *N.J.S.A.* 39:6A-2. These rates were largely based on those in the voluntary market, although drivers with accidents and violations could be subject to higher base rates and to the surcharges for the accidents and violations. Beginning in the 1970's, the Commissioner provided some subsidy

---

[4] Ordinarily, even relatively high risks can be insurable if the insurer is able to charge a premium adequate to reflect the risk. If the insurer is not able to charge such a rate or the insured is unwilling or unable to pay it, the insurer will usually be unwilling to insure the risk voluntarily.

to the assigned risk rates by directing incorporation into premium rates for all policies (including those in the voluntary market) of certain "policy constants." However, if the rates charged by an insurer, including the policy constant, proved inadequate, the insurer was obliged to absorb the loss.

In light of the high costs of no-fault insurance and the difficulty of obtaining rates which would cover those costs, many drivers who would otherwise have been attractive customers were unable to procure insurance in the voluntary market. This resulted in a very large Assigned Risk Plan. That made writing new voluntary business even less attractive, because writing such policies carried with it an obligation to accept an increased share of the loss-producing assigned-risk business.

To eliminate this obstacle to voluntary writing, the JUA Act abolished the assigned risk plan and created the JUA as a mechanism to insure those unable to procure coverage in the voluntary market. All New Jersey automobile insurers were required to be members of the JUA and some were to act as servicing carriers to issue policies, collect premiums, and handle claims on behalf of the JUA. However, neither members nor servicing carriers were to have any liability under JUA policies. *N.J.S.A.* 17:30E-7(b), -7(c), -8(a). A declared purpose of the statute was "to require that companies be made whole for losses in excess of regulated rates on all risks not voluntarily written." *N.J.S.A.* 17:30E-2. Thus, the involuntary market was no longer to act as an obstacle to provision of coverage in the voluntary market.

The JUA was to function as an entirely independent insurance company. Because it would have no capital, it was particularly important that its revenues be adequate and that proper reserves be maintained.[5]

The Legislature contemplated that the rates permitted on JUA policies would be similar to those charged in the voluntary market and, so, would not suffice to pay the losses and expenses of those policies. *N.J.S.A.* 17:30E-13. Thus, it provided the JUA with additional sources of revenue. The JUA was to receive the existing policy constants collected on voluntary-market policies and certain Department of Motor Vehicles surcharges collected from those with bad driving records. *N.J.S.A.* 17:30E-8(a); 17:29A-35. The Commissioner was also empowered to impose a residual market equalization charge ("RMEC") to be collected by insurers on every insured vehicle and remitted to the JUA. The RMEC was to be set, in light of the other resources available, to allow the JUA to operate on a no-profit, no-loss basis. *N.J.S.A.* 17:30E-3(o), 8(b).

---

[5] Insurers are required by law to maintain financial reserves sufficient to provide the benefits for which they have already collected premiums. In particular, they must maintain reserves for losses which have been incurred but not yet paid. Examples of such losses include destruction or theft of insured property whose value has not yet been determined, insured liabilities of policyholders asserted in lawsuits that have not yet been concluded, and other claims in the process of adjustment. Such losses also include those which have already occurred but have not yet been reported to the insurer, which must be estimated so that proper reserves can be maintained.

The statute also provided for the appointment of a Board of Directors ("JUA Board"), charged with adopting and filing with the Commissioner a Plan of Operation. *N.J.S.A.* 17:30E-6(a). However, the Commissioner was given total power over the operations and policies of the JUA, and had to approve the Plan before it could take effect. *N.J.S.A.* 17:30E-6(b). The Commissioner had authority to propose amendments to the Plan at any time and unilaterally to adopt those amendments if the JUA Board did not. *N.J.S.A.* 17:30E-6(d).

The JUA Plan was to provide, *inter alia*, "methods and standards for the establishment of adequate and actuarially sound reserves for unpaid losses, including provisions for incurred but not reported losses." *N.J.S.A.* 17:30E-6, -7(r). At least annually, the JUA Board was to file a statement of its financial experience with the Commissioner, including "reserve requirements for the association for the ensuing year, [and] any adjustment to previously established reserves for unpaid losses and loss adjustment expenses necessary to make such reserves adequate and actuarially sound." *N.J.S.A.* 17:30E-8(b). Statutory insurance accounting requires that amounts reserved or added to reserves be treated as expenses in calculating profit or loss.

To operate on a no-profit, no-loss basis, the JUA thus required a RMEC on voluntary-market policies sufficient to fund the necessary reserves. The JUA Plan, as approved by the Commissioner, initially required the JUA Board to recommend a RMEC computed on this basis. JUA Plan, Art. V, ¶ 2 & Operating Principles Part I, §§ 6A, 6B (Feb. 7, 1984). (ALa 231A-235A)

By November 8, 1984, the JUA Board – relying on outside consultant actuaries – recognized the JUA was operating at a loss and needed a RMEC to meet its statutory mandate to balance its books. The Board projected a $200 million deficit for 1984 and, if no RMEC were charged, a nearly $2 billion deficit for 1990. Accordingly, the Board decided to ask the Commissioner to approve a RMEC for 1985.

Rather than approve a RMEC for 1985 – a gubernatorial election year – the Commissioner mandated that the JUA adopt a cash-flow method of accounting, paying claims arising out of old policies with premiums received under new policies *without* setting aside the reserves necessary to meet the obligations arising under the policies whose premiums were thus diverted. JUA Plan, Operating Principles, Part I, § 7 (May 24, 1985). (ALa 237A-243A) The JUA Board vigorously objected to the Commissioner's proposal and took an appeal from the Commissioner's decision, but the decision was affirmed. *New Jersey Automobile Full Insurance Underwriting Association v. Hazel Frank Gluck*, Appellate Division, Docket No. A-4870-84T1 (June 19, 1988).

Adoption of cash-flow funding for the JUA made an eventual financial disaster virtually inevitable. The JUA was denied revenues adequate to fund the reserves necessary to pay for losses already incurred, thereby creating a deficit in the assets necessary to pay existing claims. On this basis, the JUA could not pay claims on policies already written without writing policies tomorrow, whose premiums could be diverted to pay claims of prior policyholders. Were the JUA to stop writing new policies, claims already incurred could not be paid unless the JUA

were given other revenues equal to that deficit (plus interest to the time the revenues were collected).

The deterioration of the JUA's financial situation caused by the prolonged freeze of its already inadequate rates and the refusal to implement RMEC's ultimately led to a situation where its ability to meet even its cash flow needs (let alone provide adequate reserves) was in jeopardy. In 1988, the Commissioner finally implemented a RMEC.[6]

The Legislature then defined a class of JUA insureds with bad driving records (two or more moving violations or one or more accidents in the preceding three years) and provided that their rates might exceed standard rates in the voluntary market by 10% in 1989, 20% in 1990, 30% in 1991, and 40% in 1992. *N.J.S.A.* 17:30E-13(a) to (d). JUA insureds not falling into this limited class of bad drivers were still to be insured at standard rates, *id.*, even though, as Deputy Commissioner Grubb noted, (ALa 72A), they have an accident frequency 35% higher than the voluntary-market drivers for whom such rates were

---

[6] The Legislature responded by allowing the JUA to defer payment of some claims and to postpone any increase in the RMEC until revenues became inadequate to fund even the reduced cash-flow needs. *N.J.S.A.* 17:30E-8.1. This statute took an interest-free loan from private insurers by permitting deferral for 12 months of payment of property damage subrogation claims, almost all of which would be due to insurers. It also permitted payment over several years, with interest, of certain tort liability claims. The result of this new deferral of funding for existing JUA liabilities was, as usual, to increase the already enormous deficit in the assets available to meet those liabilities, but to temporarily hold down the premiums to be paid by the voters.

designed. Only in 1993 was the JUA to be permitted to charge rates adequate to the risk presented by those it insured. *N.J.S.A.* 17:30E-13(e).

The 1988 legislation also sought to depopulate the JUA by returning those with better driving records to the voluntary market. *N.J.S.A.* 17:30E-14. This was not to be done by allowing insurers to charge rates which would make such drivers attractive customers, but by compelling insurers to take them whether or not they were attractive.[7] The Commissioner then determined that drivers eligible for coverage in the voluntary market were those who had not been convicted of two or more moving violations, had not received four or more vehicle "points," and had not had one or more at-fault accidents. JUA Plan, Operating Principles, Section 13, ¶ 2 (April 28, 1989). (ALa 245A)

FAIRA abolished the JUA and made certain provisions for funding its accumulated deficit. The JUA was forbidden to issue or renew any policy after September 30, 1990, so its last policies would expire by September 30, 1991. FAIRA § 16. RMEC's and policy constants were to remain in effect through March 31, 1991 and to continue to be remitted to the JUA. FAIRA § 18. However, neither RMEC's nor policy constants were to be imposed on or after April 1, 1991. FAIRA § 17.

---

[7] The Commissioner was to assign quotas for a minimum number of policies to be written by each insurer in the voluntary market, so that 60% of all vehicles would be so insured during the first year following establishment of the quotas, with the percentage rising to 70% in the second year, and 80% in the third year. *N.J.S.A.* 17:30E-14.

Termination of the JUA's ability to write new policies and of all its other usual sources of revenue made it necessary to provide new sources of funds if claims by and against JUA insureds were to be paid. These new funds were to be provided by newly-created New Jersey Automobile Insurance Guaranty Fund ("Auto Guaranty Fund"). FAIRA § 23. The lion's share of this Fund's revenues were to come from insurance companies.

For three years, automobile insurers will be taxed on their premiums (initially at a rate of 5%, but subject to adjustment) in order to yield $300 million per year. FAIRA §§ 76-77. The Commissioner must take "such action as is necessary to insure that private passenger automobile insurance policyholders shall not pay the tax." FAIRA § 78.

Additionally, for each of the eight years beginning in 1990, the existing New Jersey Property-Liability Insurance Guaranty Association ("PLIGA") is required to make a "loan" of $160 million to the Auto Guaranty Fund. FAIRA § 74(10). There are no provisions for payment of interest on these "loans." There is no commitment that the "loans" will be paid at any given time or, indeed, at all.

The PLIGA is to obtain the funds to make these "loans" by assessing all property-liability insurers in proportion to their premiums. FAIRA § 74(9) to (10). For 1990, the assessments have amounted to 2.7% of premiums written, amounting to almost $10 million for Allstate alone. (Asa Tab 5F) For other reasons, the PLIGA ordinarily makes similar assessments; insurers are not

permitted to recover them through the ratemaking process. Ordinarily PLIGA assessments instead may be recovered through surcharges on policyholders, but no surcharges may be imposed to recoup the $160 million assessments for the Auto Guaranty Fund. *N.J.S.A.* 17:30A-16; FAIRA § 75(b).

The Restructuring of the Automobile Insurance Market

FAIRA substantially restructured the New Jersey automobile insurance system. In light of the JUA's cessation of all writing on September 30, 1990, the MTF was created to arrange for the issuance and renewal of policies from October 1, 1990 through September 30, 1992. FAIRA § 88(a)-(c). It was initially to charge the JUA rates in effect on September 30, 1990. FAIRA § 88(c)(2). The losses suffered by the MTF (or, hypothetically, its profits) were to be shared among the insurers doing business in the voluntary market. FAIRA § 88(a). The depopulation of the JUA into an expanded "voluntary" market already in progress was to proceed faster and farther than previously scheduled.[8]

---

[8] At least 68% of New Jersey vehicles were to be insured in the voluntary market by October 1, 1990. FAIRA § 20. No more than 29% were to be insured by the MTF after April 1, 1991, no more than 20% after October 1, 1991, no more than 10% after April 1, 1992, and no new policies were to be issued after October 1, 1992. FAIRA § 88(c)(5). As before, insurers in the voluntary market were to be assigned quotas of voluntary-market insurance to be provided to meet these goals. *Id.* If they failed to fulfill these quotas, insureds were to be assigned to them. *Id.*

The new insurance system was structured in part by defining a broad class of "eligible persons" entitled to insurance in the voluntary market. FAIRA §§ 25-26. Such persons were to be insured through a new assigned risk plan (or through the MTF until an assigned risk plan is created), with any losses produced by rate inadequacy falling on the insurers to whom risks are assigned. FAIRA §§ 24, 88. Beginning April 1, 1991, "eligible persons" will have a statutory right to purchase insurance from any licensed insurer, as such insurers will be required to "take all comers" from that broad class. FAIRA § 27(b).

The New Jersey Insurance Ratemaking System

If an insurer's rates are inadequate, New Jersey law does not permit the resulting losses to be recovered through future rate increases. *In Re Elizabethtown Water Co.*, 107 N.J. 440, 449-51, 527 A.2d 354, 359-60 (1987); *In Re Industrial Sand Rates*, 66 N.J. 12, 23, 327 A.2d 427, 433 (1974). Yet all increases require the prior approval of the Commissioner, who has extensive power to delay or deny such increases even if well justified. As Deputy Commissioner Grubb noted, the Commissioner's power to delay or deny rate increases has been freely used to avoid making New Jersey motorists pay the full costs of the expensive automobile accident reparations system ordained by the legislature. (ALa 56)

Since 1944, the New Jersey insurance statutes have directed that rates be made "not unreasonably high or inadequate for the safety and soundness of the insurer, and which do not unfairly discriminate between risks in this State involving essentially the same hazards and

expense elements." *N.J.S.A.* 17:29A-4. This has consistently been interpreted to require that the premium should be sufficient to cover the costs of providing the particular type of insurance, including a reasonable return on the capital required to support the provision of the insurance. Specifically, New Jersey automobile insurer is entitled, absent a showing that either its business is inefficiently conducted or that a greater return is necessary, to rates which are projected to provide an "operating profit" (which takes account of the insurer's investment income attributable to insurance operations) of 3.5% of the premiums. N.J. Admin. Code 11:3-16.1; *see In Re: Application of Insurance Rating Board*, 63 N.J. 413, 307 A.2d 604 (1973).

To alter its rates, an insurer is required to file proposed amendments with the Commissioner and to obtain his approval. *N.J.S.A.* 17:29A-14. Before acting upon proposed amendments, the Commissioner could certify the filing for a hearing and is required to do so on request. *Id.*

However, until 1983, there were no limits on the time for the Commissioner to act upon proposed changes to a rating system. *Insurance Co. of North America v. Howell*, 80 N.J. Super. 236, 193 A.2d 386 (App. Div. 1963). Until the Commissioner decided, the insurer ordinarily would not have exhausted its administrative remedies and, so, would be unable to obtain substantive judicial review. After a decision, judicial review of a denial or partial denial of the insurer's application would likely consume many months, if not years. The Commissioner thus possessed almost unreviewable discretion to delay rate increases, no matter how well justified, for protracted periods.

In 1983, the Legislature imposed some time limits on the period the Commissioner may take to act on a rate application. But the Commissioner still has broad power to demand additional information before commencing hearings and there is no limit on the length of such hearings. *N.J.S.A.* 17:29A-14c.

In most lines of insurance, an insurer unable to obtain adequate rates could curtail its writings in the affected market or withdraw entirely. However, the No-Fault Act generally forbids insurers to decline to renew automobile insurance policies without the Commissioner's consent. *N.J.S.A.* 39:6A-3; *N.J.S.A.* 17:29C-7.1. The Commissioner's consent to non-renewal is granted only in extreme circumstances. N.J. Admin. Code 11:3-8.3 to 8.4. The requirement for the Commissioner's consent to non-renewal applies even when an insurer seeks to entirely withdraw from writing automobile insurance or even all insurance in New Jersey. *Sheeran v. Nationwide Ins. Co.*, 80 N.J. 548, 556-57, 404 A.2d 625, 631 (1979). FAIRA expressly prohibits withdrawal from writing automobile insurance except pursuant to a plan of orderly withdrawal approved by the Commissioner. FAIRA § 72.

Because of this, the Commissioner has substantial power to prevent or delay an insurer from curtailing its writings of automobile insurance, or withdrawing from that market, and he may attach onerous conditions to any consent for it to do so. This enormously increases the impact of the Commissioner's virtually unreviewable power to delay or deny rate increases.

In recent years a number of insurers have withdrawn or sought to withdraw from the New Jersey automobile

insurance market, and the Commissioner has consistently attached burdensome conditions to his consent to permit the necessary non-renewals. In light of FAIRA, he has formalized a policy of requiring an insurer desiring to withdraw from writing automobile insurance to cease writing any other type of insurance, but to continue writing automobile insurance (and to expand its writings pursuant to the depopulation process and the take-all-comers requirement) for five years unless it can find another insurer willing to assume its obligations in these regards. *In Re Plan of Orderly Withdrawal from New Jersey of Twin City Fire Insurance Co.*, No. A90-151 (N.J. Ins. Dept. Aug. 14, 1990). Indeed, the withdrawing insurer must cease voluntary writings, so its entire depopulation obligation must be met through involuntary assignments. *Id.*

Capping of Territorial Rate Differentials

Insurance rates vary among different locations. In setting rates for individual insureds, insurers utilize many factors which have been found predictive of the differing levels of risk presented by different insureds. In this way, each insured pays only for the risks he presents and rates can be set which make even higher-risk insureds attractive customers. Among the most important of these predictive factors is the territory in which a vehicle is located, which reflects population density, traffic conditions, repair costs, and other factors which determine the frequency of accidents and the cost levels associated with them.

In 1983, the Legislature altered the ratemaking standard for automobile insurance rates by artificially "capping" the differentials in rates to be charged various classes of insureds. *N.J.S.A.* 17:29A-36. In particular, the base rate for a particular coverage in any given rating territory, exclusive of driving record surcharges and discounts, could not exceed 1.35 times the filer's statewide average base rate for that coverage. *N.J.S.A.* 17:29A-36(c). Of course, no caps would be necessary but for the fact that cost differentials among territories or classes of insureds in the same territory would dictate rate differentials larger than those permitted by the caps. For example, claims per car in New Jersey's highest rated territory ranged from 155% to 306% (depending upon the coverage involved) of statewide average claims per car. (ALa 73A)

Artificial capping of rate differentials when actuarial data shows cost differentials exceeding the "caps" requires that some insureds be charged prices which do not reflect the full cost of the insurance provided. This resulted in creation of a class of underpriced customers, whom no insurer would voluntarily insure, thereby constricting availability of insurance in the voluntary market. (ALa 74A-75A)

The Historic and Continuing Inadequacy of New Jersey Automobile Insurance Rates and the Pending Rate Proceedings

The Insurance Department's own study showed that automobile insurers operating in New Jersey (and Allstate in particular) had suffered massive operating losses for the period 1976-88. For the years 1989-90, both the

industry and Allstate suffered further aggregate operating losses.[9] Moreover, the losses reflected in that study understated the magnitude of the overall problem of rate inadequacy because they failed to take into account the even more massive operating losses of the JUA.

The JUA's rates were so severely inadequate that, even with a subsidy from RMEC's and policy constants (currently totaling $222 for every insured vehicle in New Jersey),[10] the JUA incurred a deficit of over $3 billion. In part, this reflected the JUA's heavy concentration of business in territories where rates were especially inadequate due to territorial rate capping. As with all other insurers, the JUA rates in the capped territories were far more severely inadequate than the average for JUA rates.

The JUA's rates became those of the MTF, but the MTF will not be entitled to either RMEC's or policy constants after April 1. FAIRA § 17. Although the MTF

---

[9] As a result of these persistent operating deficits, Allstate has received no return for 15 years on the substantial capital which it has exposed to the risks of the New Jersey automobile insurance business and has actually lost roughly $37 million of that capital. (ALa 44A, ¶ 4) Had Allstate been able to realize the 3.5% operating profit which is presumptively proper under Insurance Department regulations (and Allstate contends that a higher rate is actually required under current conditions), it would have earned a total of $143 million for that period, a result prevented by the consistent refusal of Commissioners to approve adequate rates. (ALa 44A, ¶ 4) Thus, rate inadequacy for this period produced confiscation of approximately $180 million of Allstate's property.

[10] With approximately 4,300,000 New Jersey vehicles currently insured, RMEC's and policy constants currently provide a subsidy to the JUA rates of almost $1 billion annually.

has recently obtained two independent actuarial studies indicating that its rates must increase an average of roughly 60% to cover the costs of insuring its current population, it has filed for an increase averaging only 28%.[11] (ALa 187A-227A; ALa 140A-144A) By filing for a rate increase substantially less than that necessary to cover the costs of insuring its population, the MTF will impose the remainder of those costs (amounting to hundreds of millions of dollars) on Allstate and other private insurers, which are statutorily obligated to absorb the MTF's losses.[12] FAIRA § 88. Moreover, even were the MTF given the 60% indicated average increase (which it has not requested), territorial rate capping assures that the MTF rates for the capped territories would remain totally inadequate to cover the costs of insuring drivers in those territories, and involuntary depopulation assignments are made overwhelmingly from the capped territories.

---

[11] The studies show that the indicated increase of roughly 60% would allow the JUA to realize neither a profit nor a loss on the policies to be written in the year beginning April 1, 1991, but would leave voluntary-market insurers to absorb a loss of roughly $330 million from policies the MTF has written or will write at JUA rates during the period October 1, 1990 through March 31, 1991. Were the MTF to receive no increase at all, it would suffer net losses for its entire two years of underwriting totalling over $1 billion, all of which would have to be covered by voluntary-market insurers.

[12] According to a memo to the Commissioner from one of his deputies, the MTF has limited its request to 28% in order to avoid subjecting "clean" risks to any increase other than the 9.4% flex-rate increase necessary to cover inflationary cost increases. (ALa 145A-146A) Thus, the proposed increase does nothing to ameliorate the pre-existing gross inadequacy of MTF rates for such risks.

Even had Allstate's rates been adequate for the risks it insured before FAIRA became law, and Allstate submits they were not, FAIRA imposed massive additional costs which were not provided for in those rates. In addition to the taxes and assessments previously mentioned, the accelerated depopulation of the JUA requires Allstate to provide insurance at either its own existing rates or those of the JUA/MTF. Yet even with the billion-dollar annual subsidy previously provided by RMEC's and policy constants, the JUA rates (which were higher than Allstate's rates) could not cover the costs of insuring JUA policyholders, ultimately producing a deficit of over $3 billion.

Allstate has pending two rate filings which document the inadequacy of its rates to absorb the enormous extra costs imposed by FAIRA and also seek the increases necessary to support those costs. (Asa Tabs 12, 13) Both are now the subject of what seem likely to be protracted proceedings before permanent relief can be provided. Accordingly, Allstate has filed requests that it be permitted to implement the proposed increases on an interim basis, with the proceeds to be escrowed for distribution in accordance with the ultimate findings in those proceedings. (Asa Tabs 8, 9) Only if full rate relief (on at least an interim basis) is provided could Allstate's rates be even close to adequate to support the costs of depopulation assignments and the other FAIRA costs.[13]

---

[13] Developments since Allstate made its rate filings indicate that the costs imposed by FAIRA will be even greater than Allstate anticipated at the time it made those filings, so that the

(Continued on following page)

Absent a rate increase, Allstate anticipates an automobile insurance operating loss for policies written in 1991 of 35% of the premiums earned, an amount estimated at $111,000,000. (ALa 44A, ¶ 5) Of this loss, over $20,000,000 would be produced by compliance with the Depopulation Order.[14] (ALa 43A-44A, ¶ 3) Indeed, even were one to consider all of Allstate's insurance business in New Jersey, rather than just its automobile insurance business, Allstate anticipates a substantial operating loss for 1991 absent automobile insurance rate increases. (ALa 44A, ¶ 6) (Allstate does not believe that it is proper to consider other lines in pricing automobile insurance and provides this information solely to show that it would make no difference here even were that proper.)

(Continued from previous page)

increases requested would not in fact be sufficient to support the FAIRA costs. When Allstate made its October rate filing, it did not anticipate that depopulation assignments would be made from the most severely underpriced insureds in the JUA instead of from an average segment of its population. This change nearly tripled the previously estimated costs associated with the assignments which are made by the Depopulation Order. (ALa 159A) Allstate does not seek any relief at the present time based on the additional costs not anticipated by its pending filings.

[14] At present MTF rates, which are somewhat higher than Allstate rates, Allstate estimates that it will suffer an average loss on each assigned exposure of $634, for a total loss of as much as $26 million, if it is given the maximum number of assignments (25% in excess of its shortfall in achieving its quota) called for by the Depopulation Order. (ALa 43A-44A, ¶ 3) Once a policy is issued at inadequate rates, Allstate is powerless to increase the rate for that policy, so the loss resulting from the rate inadequacy becomes unavoidable.

The Depopulation Order directs the MTF to assign to Allstate 32,687 exposures (the amount by which Allstate falls short of its retroactively increased depopulation quota) in accordance with the Assignment Plan. (ALa 3) However, the Assignment Plan directs that the number of assignments specified be increased by 25%, ostensibly to cover rejections by those to whom offers of insurance are made. (ALa 9, ¶ 3) But Allstate must continue to make offers pursuant to the Depopulation Order "even when [it] has written sufficient exposures to meet its apportionment share shortfall." (ALa 10A, ¶ 8)

Assignment percentages are computed by territory. Exposures are first assigned from the territory with the smallest percentage of vehicles insured by private insurers, until the remaining JUA/MTF percentage in that territory equals that in the territory with the next lowest private market percentage, and so on until all the necessary assignments are made. (ALa 8A, ¶ 2)

Within each territory, actual assignments are made by selecting insurance producers (agents or brokers) based on the size of their books of business and the shortfall of the particular company. Each selected producer is then assigned to a company, which must make offers of insurance to that producer's existing customers as their respective JUA/MTF policies expire. (ALa 9A-10A, ¶¶ 4-6) *Every* policy is declared eligible for assignment. (ALa 9A, ¶ 4)

While the producers of assigned policies have no right to place new business with the company unless it agrees to accept such business, such producers have the

right to service their assigned policies, including submitting requests (which the insurer is required to honor) for changes in coverage, limits, options, deductibles, or cars. (ALa 16A, ¶ 21; ALa 13A, ¶ 12(b)) The assigned insurer must compensate the producer of an assigned policy and must continue to do so for as long as it insures the risk. (ALa 15A-16A, ¶ 20) It may not require the producer to satisfy any performance standards greater than those of the MTF, so that, for example, it may not require the producer to maintain errors and omissions coverage. (ALa 17A, ¶ 23) It may not terminate or discipline a producer even for violating MTF performance standards, but can only request the MTF to take disciplinary action. (ALa 17A, ¶¶ 24-25)

* * *

II. IN THE FACE OF ALLSTATE'S PRIMA FACIE SHOWING THAT THE DEPOPULATION ORDER WOULD HAVE A CONFISCATORY EFFECT, THE COMMISSIONER MAY NOT COMPEL ALLSTATE TO COMPLY WITH THAT ORDER WITHOUT FIRST CONDUCTING FURTHER PROCEEDINGS.

A. Allstate Has Made a Prima Facie Showing That The Depopulation Order Would Have a Confiscatory Effect On It.

Allstate has shown, and it is virtually admitted, that the rates it is permitted to charge for the business to be assigned are themselves inadequate even to cover the costs of providing that insurance, let alone provide a fair

return on that business.[20] Specifically, Allstate has shown that it projects an operating loss exceeding $20 million annually from issuing assigned policies at MTF rates (and, necessarily, and even larger loss if it used its own, lower rates). This showing is further bolstered by the two actuarial studies obtained by the MTF, an entity whose board members are appointed by public officials, not insurers. FAIRA § 88(b). This showing is further bolstered by the longstanding inadequacy of JUA rates which led the JUA to utter insolvency (even with a $1 billion annual subsidy which now will cease to exist). Special Deputy Commissioner Haskins has recognized this, at least in part, by recommending a 28% increase in the MTF rates.

Moreover, Allstate's showing is overwhelming when it is remembered that Allstate is not to be assigned merely a representative share of the JUA/MTF business, but is to be given business selected from the most severely underpriced of the JUA's territories, a fact which nearly triples the expected loss. (ALA 159A) Again, the Commissioner essentially admits this point when he argues that his method of selecting the risks to be

---

[20] Allstate is entitled to a fair return on the involuntarily assigned business, standing alone. *See California State Auto Ass'n v. Maloney*, 341 U.S. 105, 108 (1951) (upholding assigned risk statute because "the premiums chargeable could be commensurate with the greater risks of the [assigned] business"); *Sheeran v. Nationwide Ins. Co.*, 80 N.J. 548, 560, 404 A.2d 625, 631 (1979) (insurer forced to continue writing automobile insurance as condition of retaining its license entitled to a reasonable profit on that business). However, it is not necessary to reach that question here because Allstate faces losses on its entire New Jersey automobile insurance business and, indeed, on *all* of its New Jersey insurance business.

assigned was adopted in order to avoid the need for an "extraordinary increase" in the MTF rates. (Csb 11)

Nor can the loss imposed by the Depopulation Order be supported by profits from Allstate's voluntary automobile insurance business, for Allstate has shown that it is experiencing massive operating losses as a result of the Commissioner's refusal to approve adequate rate increases. This showing is bolstered by the Insurance Department's profitability study, which showed large industry-wide operating losses for the period 1976-88, including losses in 10 out of 13 years. Moreover, the Commissioner would not feel the need to erect ever-higher barriers to withdrawal from the automobile insurance business if automobile insurers could expect to earn profits adequate to attract capital to the business.

Finally, Allstate has shown that, a present rates, any profits it might hope to make in other New Jersey lines of insurance will be completely overwhelmed by its automobile insurance losses, thus producing a large aggregate operating loss on all New Jersey insurance operations of Allstate and its affiliates. Thus, even at this level, there would be no profits to support the losses which would be imposed by the Depopulation Order. By any standard, Allstate has made a prima facie showing that the Order has confiscatory impact.

If Allstate is forced to issue policies pursuant to an inadequate rate structure, it will suffer irreparable harm. To begin with, once a policy is issued at an inadequate rate, Allstate is powerless to alter that rate for the duration of the policy. Each such policy, once issued, will

produce an average loss equal to the deficiency in the applicable rate.

Nor may Allstate recoup any such deficiency in today's rates by attempting to charge higher rates at some time in the future. Rates must be fixed solely with reference to the anticipated costs of the service to be provided in the period to which they will apply; past rate deficiencies may not be used as a basis for future charges higher than otherwise justified. *In Re Elizabethtown Water Co.*, 107 N.J. 440, 449-51, 527 A.2d 354 359-60 (1987); *In Re Industrial Sand Rates*, 66 N.J. 12, 23, 327 A.2d 427, 433 (1974). Consequently, "rates must provide a constitutional return *in the [period] in which they are in effect.*" *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 230, 394 A.2d 65, 80 (1978) (emphasis added), *app. dism'd*, 440 U.S. 978 (1979).

B. Allstate Is Entitled to the Opportunity to Earn a Fair Rate of Return on Its New Jersey Business.

The power to regulate a business does not include the "power to compel the doing of [regulated] services without reward." *Troy Hills Village v. Township Council*, 68 N.J. 604, 620, 350 A.2d 34, 42 (1975). Nor may such a business be compelled to subsidize the needs of its customers. *Id.*

The United States and New Jersey Constitutions require New Jersey to allow businesses the opportunity to earn a fair rate of return on their activities in the State. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 223, 394 A.2d 65, 70 (1978), *app. dism'd*, 440 U.S. 978 (1979). This means that regulated rates must be sufficient not only to cover

costs and expenses, but also to yield a profit "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citations omitted). "[T]he return should be one which is commensurate with returns on investments in other enterprises having comparable risks." *Hutton Park Gardens v. West Orange Town Council*, 68 N.J. 543, 570, 350 A.2d 1, 14-15 (1975). Even apart from constitutional considerations, the Legislature has directed that insurers be permitted a fair rate of return. N.J.S.A. 17:29A-4; FAIRA § 2(g); *see* N.J. Admin. Code 11:3-16.2. To force insurers to suffer massive and unrecoverable losses would thus impermissibly confiscate property.

These standards apply even where the regulated party is free to avoid the confiscatory effect by abandoning the business. *Hutton Park Gardens*, *supra*, 68 N.J. at 568-69 n.9, 350 A.2d at 14 n.9. But they are especially compelling when, as here, the regulated party is forbidden to abandon the business and has also been conscripted to take on substantial volumes of underpriced new business.

C. Allstate's Showing of Confiscation May Not Be Avoided by Reliance on Past or Future Flex-Rate Increases or the Possibility That Allstate Might File a Non-Standard Rating Plan.

In response to Aetna's motion for a stay, the Commissioner relied on two avenues of rate relief which he claimed Aetna had ignored and which might ameliorate any confiscatory impact. (Csb 18) He alleged that Aetna

was entitled to file for an automatic flex-rate increase of up to 6% now and another such increase (in an as-yet unknown amount) on July 1, 1991. He also alleged that Aetna was entitled to file for a non-standard rate level of up to 35% above its average rate level.

1. Flex-Rate Increases Are Not a General Solution to the Problem of Regulatory Lag.

Allstate has already taken a flex-rate increase, on July 1, 1990, and will not be entitled to another until July 1, 1991. Thus, such an increase can be of no current assistance. More generally, while flex-rate increases do reduce the impact of regulatory lag in processing rate applications, they do not ameliorate the types of rate inadequacy present here.

Flex-Rate increases are designed to avoid delaying rate adjustments necessary to provide for certain increasing costs which could be shown or anticipated without specific examination of the experience of individual companies. *N.J.S.A.* 17:29A-44. Beginning July 1, 1989, insurers were permitted to make annual "flex-rate" increases based on the percentage increase in specified components of the Consumer Price Index, relating to medical services and automobile repairs. Flex-Rate increases were thus designed to provide automatic relief for certain categories of increasing costs, with the result that adequate rates would be less likely to become inadequate with passage of time. However, flex-rate increases could not cure pre-existing rate inadequacy and they make no provision for cost increases resulting from new legislation or other extraordinary events.

Because the problems of rate inadequacy created by the Depopulation Order are the result, not of rising medical and automobile repair costs, but rather of wholesale restructuring of the automobile insurance system, last July's flex-rates could not eliminate those problems. Moreover, next July's increase will merely compensate for rising medical and repair costs which have occurred in the last seven months, and will occur in the next five, without regard to the restructuring of the system. Thus, they too will be unable to compensate for rate inadequacies created by the restructuring. Finally, next July's increase may be delayed by as much as nine months if the Public Advocate objects to it. FAIRA § 36, *amending* *N.J.S.A.* 17:29A-44f.

2. Non-Standard Rate Plans Offer No Immediate Relief and Only Minimal Ultimate Relief, So They Cannot Avoid the Need for Other Action To Protect Against Rate Inadequacies.

It is now true, as the Commissioner says, that implementation of a non-standard rating plan could provide some additional revenues for Allstate and other insurers.[21] But a non-standard rating plan must be filed with Commissioner, and must be approved by him before

---

[21] Prior to November 26, 1990, it was the Commissioner's policy that no non-standard rating plan could be approved which did not reduce the standard rates sufficiently to offset any revenue from the increased rates. Under that requirement of revenue neutrality, mere filing of a non-standard rate plan could not result in any additional revenues to the filer. That requirement was eliminated by emergency regulations promulgated on November 26, 1990. (ALa 285A, ¶ 3; ALa 286A, ¶ 5)

it can be put into effect. *N.J.S.A.* 17:29A-45. Under FAIRA, such a plan must comply with certain determinations made by the Commissioner. FAIRA § 37. Prior to November 26, 1990, the Commissioner had not approved any method of making such determinations. (ALa 286A, ¶ 4) Before that time, insurers could not even begin to design such a plan.

Moreover, permanent regulations were not adopted until January 25, 1991, the day after the Depopulation Order was entered. While emergency regulations had been promulgated on November 26, 1990, they were necessarily effective only briefly and there could be no advance assurance that the permanent regulations would be the same or even similar. Thus, it was not prudent to expend substantial efforts designing and filing a plan which might not comply with the final regulations. (ALa 286A-287A, ¶ 6)

The final regulations were adopted on the eve of the hearing on Allstate's October 15 rate filing. The personnel who are responsible for designing and filing the non-standard rate plan were and are heavily involved in that hearing and have not yet had sufficient time to also act in response to adoption of the final regulations. However, Allstate will file such a plan by March 1, as required by the regulations. (ALa 287, ¶ 7)

Accordingly, Allstate has not yet had a fair opportunity to file a non-standard rate plan. Moreover, there is no assurance that, had Allstate somehow managed to do so, its plan would have been or would soon be approved. Thus, such a plan cannot and could not fairly be relied

upon as a source of immediate relief or relief at any time in the near future.

Moreover, the relief provided by the filing of a non-standard rating plan would be minimal. Only 15% of drivers can be placed in such a plan. FAIRA § 37. Allstate has made an analysis of various designs it might employ and finds that such a plan might provide revenues amounting to about 6% of standard premiums. (ALa 287A, ¶¶ 8-9) However, implementation of such a plan would also require Allstate to eliminate its existing system of surcharges for accidents and violations, which surcharges amount to roughly 3% of its existing revenues. (ALa 287A-288A, ¶ 10) Thus, implementation of a non-standard rating plan would provide additional revenues roughly equal to a 3% rate increase. (ALa 289A, ¶ 11) While such revenues would be welcome, they would not even approach the levels necessary to prevent a confiscatory impact from the Depopulation Order.

Finally, even a non-standard rating plan would do little to respond to the specific problems of the Depopulation Order. Most drivers in the JUA are there not because they have bad driving records, but simply because insurers are not permitted to charge rates adequate to the risks they present.

D. Current Confiscatory Impact Is Not Justified by the Mere Prospect That Currently Pending Rate Proceedings May Eventually Lead to the Setting of Non-Confiscatory Rates.

Unless the losses suffered on account of currently inadequate rates will be compensated at some future

time, current confiscation cannot be justified on the basis that it will continue only until determination of a final rate or completion of some other proceeding. *Prendergast v. New York Telephone Co.*, 262 U.S. 43 (1923). In *Prendergast*, a telephone company was ordered to reduce its rates pending completion of hearings to set rates. The order was said to be "temporary," but (as is true in New Jersey) no procedure was available to recoup in the future any deficits which might be incurred while the "temporary" order was in effect. The Supreme Court sustained a preliminary injunction staying the rate reduction but requiring the company to refund any charges above the level originally ordered which were later found excessive.

The Court held that the ostensibly temporary character of the order did not

> deprive the company of its right to relief at the hands of the court. The orders required the new reduced rates to be put into effect on a given date. They were final legislative acts as to the period during which they should remain in effect pending the final determination; and if the rates prescribed were confiscatory the Company would be deprived of a reasonable return upon its property during such period, without remedy, unless their enforcement should be enjoined. Upon a showing that such reduced rates were confiscatory the Company was entitled to have their enforcement enjoined pending the continuance and completion of the rate-making process.

Id. at 49. *Accord Smith v. Illinois Bell Tel. Co.*, 270 U.S. 587, 591-92 (1926) (company suffering from interim confiscatory rates is not required "to await a decision of the

ratemaking tribunal before applying to a federal court for equitable relief").

To be sure, it may not be possible to determine finally what rates are required prior to completion of a full rate proceeding. To deal with this problem, there is a well-established procedure by which a temporary, interim rate increase may be granted on the basis of a preliminary showing, with the proceeds of that increase to be held in escrow pending conclusion of the rate proceeding, subject to refund (with interest) to whatever extent the interim increase is ultimately found not to have been justified. *See In Re Industrial Sand Rates*, 66 N.J. 12, 25-6, 327 A.2d 427, 434-35 (1974); *New Jersey State AFL-CIO v. Bryant*, 55 N.J. 171, 176-77, 260 A.2d 225, 227-28 (1969). In this way, the regulated company is protected from irreparable loss of revenue to which it is entitled while ratepayers are protected against any ultimate liability for amounts in excess of those which they are in fact obliged to pay.

To be sure, a regulated company is not *routinely* entitled to rate relief prior to completion of a rate proceeding.

> "It is true . . . that a utility is entitled to rates that are just and reasonable; but this is not to say that rates must fluctuate automatically with every change in economic conditions or that a reasonable time may not be allowed for determining the reasonableness of a proposed increase in rates before it is allowed to go into effect. Any loss sustained by a maintenance of the status quo while such determination is being made is properly considered, not as a violation of constitutional right, but as a necessary incident of rate regulation so long as the period of

> suspension does not 'overpass the bounds of reason.' "

In Re N.J. Power and Light Co., 15 N.J. 82, 90, 104 A.2d 1, 5 (1954), *quoting Hope Natural Gas Co. v. Federal Power Commission*, 196 F.2d 803 (4th Cir. 1952).

But this is not a case in which the rates were previously set to provide a fair and reasonable return as to the very business which the regulated company would be conducting pending the establishment of new rates. In such a case, it may sometimes be proper to presume that those rates remain fair and reasonable until a full hearing has shown otherwise. Here, however, the Commissioner seeks to change the status quo by compelling Allstate to undertake a substantial volume of new business, with characteristics very different than the business for which Allstate's rates were set. Moreover, no fair and reasonable rates were ever previously established for the business Allstate would be forced to take: the JUA rates were always based on cash-flow underwriting (which Allstate is legally forbidden to conduct and which would inevitably confiscate Allstate's property to satisfy obligations for which no reserves would be provided) and, more recently, on a billion-dollar annual subsidy which will not be available to Allstate. Thus, there is no room for any presumption that existing rates are fair and adequate.

Nor is the need for emergency relief the result of any lack of diligence by Allstate. In light of FAIRA's apparent prohibition on recovery of the taxes and assessments it imposed, Allstate acted diligently by applying for rate relief relating to those taxes and assessments in August, promptly after the Commissioner announced the position

that they might be recoverable in some circumstances. (ALa 44A-45A, ¶7) The Commissioner has also indicated, in the litigation relating to that filing, that no action could have been taken on such a filing, even had it been made earlier, because he had not yet developed the standards applicable to such filings.

Allstate also acted diligently in making its October filing promptly after it became possible to estimate (inadequately, as subsequent events have shown) the rate levels to be required in light of FAIRA and related developments. (ALa 44A-45A, ¶7) The October filing was made in time for the Commissioner to act, at least on an interim basis, prior to issuance of depopulation assignments.

In these circumstances, and in the face of a prima facie showing that the Depopulation Order will have a confiscatory impact, the Commissioner may not summarily require compliance by simply pointing to a pending rate proceeding which might someday result in prospective elimination of any rate inadequacy.

E. If the Commissioner Chooses To Deny All Rate Relief While Insisting on Compliance With the Depopulation Order, He Must Do So On the Basis of a Judicially Reviewable Determination That No Confiscation Will Result.

This Court may not make rates. *In Re Industrial Sand Rates*, 66 N.J. 12, 19, 327 A.2d 427, 431 (1974). "However, in matters of substantial constitutional dimension the Executive and the Legislature are not the determining or final arbiters." *Valent v. New Jersey State Board of Education*, 114 N.J. Super. 63, 69, 274 A.2d 832, 836 (Ch. Div.

1971). *See also Campbell v. Office of Personnel Management*, 694 F.2d 305, 307 (3rd Cir. 1982) (legislature "cannot preclude judicial review of allegedly unconstitutional legislative action"). Thus, the Commissioner may not be permitted to act as the sole arbiter of an insurer's right not to have its property taken by the maintenance of confiscatory rates while compelling it to take on new business not provided for in those rates.

Because Allstate will have no ability to recover any inadequacy from its policyholders, current or future, the Commissioner will be the sole arbiter if he may, without affording rate relief, compel Allstate to comply with the Depopulation Order in the face of the prima facie showing of confiscation made here. That cannot be permitted. *See, e.g., Alaska Public Utilities Comm. v. Greater Anchorage Area Borough*, 534 P.2d 549, 556-60 (Alaska 1975) (denial of interim relief reviewable where rate proceeding likely to be prolonged).

Similarly, if this Court were simply to accept the Commissioner's assurance (which Allstate expects will be forthcoming) that he finds Allstate's rates adequate, the Commissioner would be left as sole arbiter of Allstate's constitutional claims. On the other hand, this court cannot, on the present record, resolve the dispute between Allstate and the Commissioner on that point. But this Court can and should order that the Commissioner not demand Allstate's compliance with the Depopulation Order, absent the rate relief necessary to obviate the confiscatory impact shown prima facie by Allstate, until the Commissioner first makes a finding, supported by an administrative record, that no confiscation will, in fact, occur. If such a determination were made and if Allstate

disputed it, this Court could then review the Commissioner's action, so that the Commissioner would not be left to pass an unreviewable judgment on Allstate's claims.

APPENDIX 11

IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO ALLSTATE INSURANCE COMPANY	) SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2631-90T5F
and	
IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO THE AETNA CASUALTY AND SURETY COMPANY	) SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2628-90T5F
and	
IN THE MATTER OF THE ASSIGNMENT OF EXPOSURES TO COLONIAL PENN INSURANCE COMPANY,	) SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-2783-90

REPLY BRIEF OF APPELLANT
ALLSTATE INSURANCE COMPANY

Of Counsel &
On the Brief:

William J. Brennan, III
Suzanne M. McSorley

SMITH, STRATTON, WISE,
HEHER & BRENNAN
600 College Road East
Princeton, New Jersey 08540
(609) 924-6000
Attorneys for Appellant
Allstate Insurance Company

Of Counsel &
On the Brief:

Duane C. Quaini
William T. Barker
Jeffrey P. Lennard
Steven M. Levy

SONNENSCHEIN NATH &
ROSENTHAL
8000 Sears Tower
P. O. Box 932
Chicago, Illinois 60606
(312) 876-8000
Attorneys for Appellant
Allstate Insurance Company

TABLE OF CONTENTS

* * *

* * *

II. THE COMMISSIONER MAY NOT SIMPLY IGNORE A PRIMA FACIE SHOWING OF CONFISCATION WHEN ATTEMPTING TO COMPEL AN INSURER TO TAKE ON A SUBSTANTIAL VOLUME OF NEW BUSINESS (A) FOR WHICH NO ADEQUATE RATES HAVE EVER BEEN FIXED AND (B) WHICH THE INSURER'S RATES WERE NEVER DESIGNED TO SUPPORT.

The Commissioner makes four responses to Allstate's attack on the validity of compelling it to accept depopulation assignments at inadequate rates. First, he mischaracterizes Allstate's attack as a facial challenge and ignores Allstate's demonstration of a confiscatory effect. (Cb 31) Second, he points to the possibility (already addressed at ALb 54-58) of obtaining some rate relief from flex-rate increases and the filing of a rating plan for non-standard risks. (Cb 32-33) Third, he argues that, as a matter of administrative procedure, this Court may take no action regarding Allstate's claims of confiscation until pending rate proceedings are completed. (Cb 33-34) Finally, he asserts that, as a matter of substantive law, an insurer has no right to adequate rates until completion of a rate proceeding. (Cb 35-38)

A. Allstate Has Made A Prima Facie Showing That The Depopulation Order Will Have A Confiscatory Effect.

The Commissioner asserts that:

> Aetna and Allstate request this Court to find Section 20 of the FAIR Act facially unconstitutional

> because under no conceivable set of circumstances could an insurer realize a just and reasonable return.

(Cb 31) This misstates Allstate's argument. Allstate readily admits that the accelerated depopulation mandated by Section 20 of FAIRA *could* be implemented in a way that would allow insurers generally (and Allstate in particular) to realize a just and reasonable return. Thus, Allstate recognizes that Section 20 is not, in and of itself, facially unconstitutional. Rather, Allstate specifically challenges the *manner* in which the Commissioner has implemented that section because, as applied to Allstate, that implementation precludes a just and reasonable return.

Nor does Allstate rely solely on "speculative assumptions on potential losses." (Cb 31) In particular, Allstate does not rely (Cb 31) simply on the fact that its standard rates are too low, for it would utilize MTF rates so long as those rates remain higher than Allstate's own. Rather, Allstate placed before the Commissioner extensive evidence of the inadequacy of its rates to sustain the losses which would result from the new business he now seeks to assign to Allstate. There can be little doubt that the assigned business *will* produce massive losses.

First, the MTF rates Allstate is permitted to charge for this new business are rates which were deliberately set to cover only *immediate* cash flow needs rather than supporting maintenance of the reserves necessary to pay *all* claims resulting from those policies. (ALa 237a; *see* ALb 17-19) Use of those rates generated a $3 billion

deficit for the JUA before its existence was terminated. That deficit was created despite the JUA's receipt, over and above the premiums calculated pursuant to its rates, of an enormous subsidy,[7] which will now cease to exist.

Second, two independent actuarial studies commissioned by the MTF found that its rates needed to be increased by over 60% simply to cover out-of-pocket costs of providing the insurance, with no reward for the exposure of capital to the risks of that insurance. (ALa 187a-227a) Even the Insurance Department recognized that the MTF rates are inadequate to operate on the statutorily-required "no-profit, no-loss" basis and that at least a 28% increase in those rates is necessary.[8] (ALa

---

[7] In Allstate's opening brief, this subsidy was estimated at "almost $1 billion annually." (ALb 28 n.10) For 1989, the precise amount was $810,326,504. *Annual Statement of the New Jersey Automobile Full Insurance Underwriting Association to the Department of Insurance for the State of New Jersey for the Year Ended December 31, 1989* 18. Given increases in the number of insured vehicles, the figure for 1990 would be roughly $900 million. For present purposes, the exact magnitude of the figure does not matter. It is enough that it is enormous.

[8] The refusal to recommend a larger increase was *not* based on any question as to the validity of the showing that a 60% increase was required. Rather, it was explicitly based on a desire not to increase the rates of "good drivers" in the MTF by more than the 9.4% "flex-rate" increase necessary to allow for inflationary cost increases, *regardless of whether such an increase was adequate to cover the costs of their insurance.* (ALa 146a)

145a-46a) Allstate's own actuaries project an average annual loss of $634 per policy at MTF rates. (ALa 43a)

Moreover, the risks to be assigned are not merely an average group of JUA/MTF risks, with an average level of rate inadequacy. They are risks systematically selected from the rate territories least attractive to private insurers. As Deputy Commissioner Grubb found, statutory rate-capping requires that rates in the highest-risk territories[9] be set at levels significantly below levels reflecting actual territorial loss costs. (ALa 84a) Thus, even were JUA/MTF rates adequate, on average, for all the risks they insure, they would necessarily be inadequate for the subset of those risks which are located in the capped territories. When rates are not adequate, on the average, as the record shows MTF rates are not, the rates for risks in the capped territories will necessarily be more inadequate than average.

---

[9] Those territories are urban territories. Allstate does not contend, as the Commissioner suggests (Cb 34), that "urban drivers are . . . *per se* bad drivers." Allstate simply contends that drivers in those areas have substantially higher losses than those in other areas. This may just reflect the greater accident frequency to be expected with greater traffic density, or there may be other reasons as well. But whatever the cause of this higher risk level, it is a fact. (ALa 84a) That fact must be taken into account in assessing the adequacy of the rates charged to a population disproportionately composed of drivers from those territories.

Similarly, Allstate has presented evidence of the inadequacy of its own rates to cover the costs of insuring its present customers, let alone the losses to be produced by the assignments made by the Depopulation Order. (ALa 43a-45a; Asa Tabs 12, 13) Specifically, Allstate projects a 1991 operating loss of $111 million on New Jersey auto insurance business (including over $20 million attributable to the assigned business) and a substantial operating loss on its entire New Jersey insurance business.[10]

Another way of looking at Allstate's prima facie showing is in terms of the presumptions flowing from operation of the regulatory structure. Once rates have been fixed which are just and reasonable, they are presumed to remain just and reasonable until the contrary is

---

[10] The Commissioner has included in his appendix testimony purporting to show that Allstate made money in the period 1985-89. (Ca 199A-200A) Lest this Court uncritically accepts that showing, Allstate mentions a few of the most important errors in this information. First, it included in the profit stated the return Allstate received from investment of the capital with which it backed its New Jersey policies. That income would be available even if Allstate did not engage in the insurance business and need not be credited to shareholders in fixing a just and reasonable return for that business. *See. e.g., In re Application of Insurance Rating Board*, 63 N.J. 413, 414-19, 307 A.2d 604, 605-07 (1973). Second, the data fails to reflect certain sizeable dividends which Allstate paid to policyholders to eliminate excess profits otherwise refundable under *N.J.S.A.* 17:29A-5.6-5.16. Third, the time period is distorted because elimination of the financially draining assigned risk business through formation of the JUA temporarily produced unusual profits in 1985 and 1986, which were not repeated in 1987-1990, and will not be repeated in 1991 or subsequent years.

shown. *See, e.g., Swift & Co. v. United States*, 343 U.S. 373, 382-83 (1952). Where, as is the case with the JUA/MTF rates, rates were deliberately set at a level which was not just and reasonable, then it should likewise be presumed that they have not spontaneously become just and reasonable.

Nor can this presumed inadequacy on the assigned business be made up by any excess profit on Allstate's other business. Allstate's present automobile insurance rates were approved by the Commissioner long before FAIRA.[11] Even if, despite FAIRA's imposition of new taxes and assessments, Allstate's rates could be presumed to remain adequate for the voluntary business with respect to which those rates were set, they surely must also be presumed not to be excessive for that business. Accordingly, the voluntary business would provide no excess profits which could subsidize losses from the depopulation assignments. Thus, the Commissioner's own system of rate regulation supports a presumption that the Depopulation Order *will* have a confiscatory effect on Allstate.

Most of this evidence was presented to the Commissioner, in rate applications, well before he issued the

---

[11] Allstate's last general rate increase took effect in March, 1989. Since that time, Allstate has also taken two flex-rate increases, which are designed simply to protect Allstate against inflationary cost increases. *N.J.S.A.* 17:29A-44a. The Commissioner has the power to limit flex-rate increases if he believes that they will produce excessive rate levels. *N.J.S.A.* 17:29A-44d.

Depopulation Order. Its relevance was called to his attention on a motion for an administrative stay of that Order.[12] The issue before this Court is whether he was free to simply ignore this evidence and demand compliance with the Depopulation Order despite a prima facie showing that the Order would have a confiscatory effect.

B. The Commissioner May Not Simultaneously Demand Both Immunity From Judicial Review And Immediate Compliance With a Final Order Which Has Been Shown Prima Facie To Be Confiscatory.

The Commissioner argues that this Court cannot determine the adequacy of Allstate's rates on the record now before it "without the benefit of a hearing and decision below." (Cb 31) Allstate recognizes that this is true and does not ask this Court to make such a determination.

Many of the cases cited by the Commissioner (Cb 32, 37) are concerned with the need for a full factual record and/or with protection of the integrity of the administrative process and its ability to sift through the underlying

---

[12] The Commissioner could have acted at any time, at least on an interim basis, to permit the requested increases in Allstate's rates. Similarly, he might have acted at any time to allow an increase in the MTF rates. Finally, the precise terms and content of the Depopulation Order were not clear until he issued it. Thus, not until the Depopulation Order was issued *without* any action on the proposed rate increases was there a clear basis for presenting a more detailed claim based on the confiscatory impact of the Depopulation Order itself. Allstate presented that claim promptly after it arose.

facts before any judicial determination is made regarding those facts. Allstate recognizes these concerns as well, and does not seek any substantive consideration of whether its rates are actually adequate, either generally or for the depopulation business the Commissioner seeks to assign.

But this is not a case where judicial intervention is "premature" – Allstate is subject to a final administrative order. Despite Allstate's prima facie showing that the Depopulation Order will have a confiscatory effect, the Commissioner demands immediate compliance, thereby threatening irreparable harm to Allstate. Judicial review at this juncture is both timely and essential to protection of substantive rights.

Finally, this is not a case where *Allstate* seeks alteration of the status quo by demanding an increase in the rates charged on its existing business. *Compare Public Util. Comm'n v. Pedernales Elec. Coop.*, 678 S.W.2d 214 (Tex. App. 1984). It is *the Commissioner* who seeks to change the status quo by requiring Allstate to take on a vast quantity of new business whose costs and risks differ from its existing business.

Where judicial review is essential but administrative proceedings are a necessary predicate to an ultimate decision, it is proper to require that the administrative process be conducted in a way which will accommodate both needs. *See. e.g., State Farm Mutual Auto Ins. Co. v. State*, 118 N.J. 336, 348-50, 571 A.2d 957, 963-64 (1990); *Abbott v. Burke*, 100 N.J. 269, 297-98, 495 A.2d 376, 391-92 (1985). That is what Allstate proposes here.

Under the procedure Allstate suggests, further administrative review of an order said to have a confiscatory effect would be triggered upon presentation to the Commissioner of a prima facie showing of that effect. The Commissioner could then take any of a number of actions. First, he could allow rate relief sufficient to obviate the effect shown. This could be final relief if that were appropriate, but could also be temporary, interim relief pending further review (and subject to refund if that review showed it not actually justified). Second, he could withdraw, modify, or defer the order said to produce the confiscation, again obviating the forbidden effect. Third, he could examine the underlying facts and make a determination that no relief is necessary because no confiscation would result.

Whichever course the Commissioner took, his action could be judicially reviewed on an appropriate record. What the Commissioner would not be permitted to do is what he did here: ignore the showing of confiscation, demand immediate compliance, and claim that judicial consideration of the confiscation claim is barred because that claim was not resolved administratively.

The procedural scheme Allstate suggests both protects against abridgment of the substantive constitutional right not to have property taken without just compensation and respects the primacy of the Commissioner in his legislatively delegated sphere. No issue would be adjudicated until the agency has passed on it. Nor does this procedure demand impossible speed in resolving what may be difficult questions presented by the confiscation claim. If appropriate, the allegedly confiscatory order may be stayed pending such resolution. If some other

public interest demands more immediate compliance with that order, then interim rate relief may be granted, protecting against irreparable harm either to the insurer (who will be permitted to collect the necessary revenue and to retain it if the increase is found to have been justified) or to its customers (who will be assured of refunds, with interest, if the increase is found not justified).[13]

C. The Constitution Does Not Permit Confiscation Of Property To Be Accomplished By Imposition Of New Public Duties Without Adjustment Of Pre-Existing Rates, Even During The Pendency Of A Rate Proceeding.

The Commissioner boldly asserts that it would not matter even were it established that confiscation would

---

[13] Without such a procedural scheme, one of two alternatives must be accepted. First, the aggrieved insurer could be permitted to seek direct judicial intervention, in the nature of an injunction, in which proceedings its claims of confiscation would be assessed by a court in the first instance. This is surely not what the Commissioner urges here, and it would sacrifice the benefits of initial administrative consideration. *See United States v. RCA Alaska Communications. Inc.*, 597 P.2d 489, 494-95 (Alaska 1979) (court may adjudicate utility's right to interim relief, but must do so solely by reviewing administrative record and findings). What he does urge is the only remaining alternative, that the insurer claiming confiscation be left solely to the grace of the Commissioner to protect its rights. That alternative, however, would unlawfully sacrifice substantive constitutional rights to mere procedural convenience. *Cf, Smith v. Director, Division of Taxation, supra*, 108 N.J. at 33, 527 A.2d at 850 (procedural convenience does not justify abrogation of statutory rights).

result from imposition of depopulation assignments without alteration of current rates, because "[d]ue process rights may be diminished, by the imposition of confiscatory rates, pending a final administrative hearing on a request for increased rates." (Cb 37) But even the line of cases he cites does not support that proposition, and especially not in this context.

At most, those cases support the proposition that where a company has voluntarily assumed a duty to provide public service as a utility and rates have been established for the performance of that duty, the regulator may be entitled to briefly maintain the status quo pending review of a request for an increase in the rates for the existing public service.[14] But Allstate has not voluntarily undertaken a duty to provide public service; that duty has been imposed upon it against its will by

---

[14] Most of these cases also depend heavily on the need to refrain from premature intervention in the administrative process. As just shown, that problem is not presented here. Moreover, *Public Util. Comm'n v. Pedernales Elec. Coop.*, 678 S.W.2d 214, 222-23 (Tex. App. 1984), relied on the statutory right of the utility there to implement an interim increase if the effective date of its increase was delayed 90 days, as has happened here. It does not support legality of the instant prolonged and indefinite delay.

Additionally, the leading case in this line (and several subsequent cases) involved an attempt to obtain retroactive application of a rate subsequently approved to a period before its approval. *Hope Natural Gas Co. v. FPC*, 196 F.2d 803, 804 (4th Cir. 1952). Even had the prior rates in that case been confiscatory, *that* attempt would have violated the requirement that all ratemaking be purely prospective. *See In re Industrial Sand Rates*, 66 N.J. 12, 23, 327 A.2d 427, 433 (1974).

enactment of the JUA depopulation statute and FAIRA. Allstate's rates were never set to cover performance of its newly imposed public duties, so they cannot be presumed adequate for those duties. And the regulator is not maintaining the status quo but altering it by demanding performance of onerous new duties without any corresponding adjustment of the rates allowed as compensation for the service to be provided.

Even in the special context presented by the Commissioner's line of cases, there can be a right to timely rate relief before completion of lengthy rate proceedings. As the Michigan Supreme Court has explained:

> A public utility has a substantive right, set forth in the statutes and rooted in the constitution, to rate relief where the revenue produced by an existing rate structure is less than the amount required by the statutes or the constitution. A public utility has, as a corollary to that substantive right, a right to immediate relief where compelling circumstances indicate that such relief is necessary.
>
> * * *
>
> The substantive right to rate relief includes the right to a determination, following a hearing if necessary, whether immediate or permanent relief shall be granted.[15]

---

[15] *Consumers Power Co. v. Michigan Public Service Comm'n*, 415 Mich. 134, 145, 327 N.W.2d 875, 878-79 (1982) (footnotes omitted) (affirming judicial order permitting interim rate increase pending completion of rate proceedings, denied by regulator); *Alaska Public Utility Comm,n v. Greater Anchorage*

(Continued on following page)

The New Jersey Supreme Court has also recognized that interim relief, prior to completion of a rate proceeding, is sometimes necessary to permit a regulated business "to escape the unfair *and sometimes confiscatory* impact of 'regulatory lag' *i.e.*, the considerable time necessary for final resolution . . . of a rate increase." *In Re Industrial Sand Rates*, 66 N.J. 12, 25, 327 A.2d 427, 434 (1974) (emphasis added).

That such form of relief is necessary on the facts here may be seen from *Calfarm Insurance Co. v. Deukmejian*, 48 Cal. 3d 805, 258 Cal. Rptr. 161, 771 P.2d 1247 (1989).[16] There, the services required from insurers were not changed, but their rates were to be rolled back 20% by statute. The effect obviously would be similar to requiring increased services and leaving the rates unchanged. To sustain the constitutionality of the statute, it was found *necessary* to provide insurers with the opportunity to obtain interim relief if they could show that either the statutory rollback or, subsequently, the delay

---

(Continued from previous page)

Area Borough, 534 P.2d 549, 558 (Alaska 1975) (same); *City of Tyler v. Television Cable Service. Inc.*, 481 S.W.2d 166, 172 (Tex. Civ. App. 1972) (utility entitled to interim judicial relief to prevent irreparable harm from occurring while it exhausted its remedies before regulatory body).

[16] *Calfarm* relied upon and further developed the principles laid down in *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A.2d 1 (1975), and *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976). The *Birkenfeld* analysis was itself followed in *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 226, 394 A.2d 65, 76-78 (1978), *app. dism'd*, 440 U.S. 978 (1979). Thus the analysis utilized in *Calfarm* has been approved by the New Jersey Supreme Court.

incident to a rate proceeding, would have a confiscatory effect. *Id.* at 816-26, 258 Cal. Rptr. at 166-73, 771 P.2d at 1252-59. With respect to the statutory rollback, insurers were permitted to continue using their existing rates (without any rollback, subject to future refund if later found excessive) until the regulator determined what rates were proper.[17] *Id.* at 825, 258 Cal. Rptr. at 172-73, 771 P.2d at 1258-59.

It has long been recognized that "[p]roperty may be as effectively taken by long-continued and unreasonable delay in putting an end to confiscatory rates as by an express affirmance of them." *Smith v. Illinois Bell Telephone Co.*, 270 U.S. 587, 591 (1926). Regulatory delay is surely unreasonable where the regulator himself proposes to heap costly new duties on the regulated industry while refusing to permit concomitant rate increases necessary to permit just and reasonable compensation for performance of those new duties. If a confiscatory effect is shown

---

[17] A lower California court later held that an insurer seeking a rate *increase* may be forced to wait a reasonable time for completion of a rate proceeding without any right to interim relief. *Allstate Ins. Co. v. Gillespie*, 275 Cal. Rptr. 525, 538-42 (Cal. App. 2d Dist. 1990). Even were *Gillespie* correctly decided, it would be inapposite here. It relied primarily on the need to avoid premature interference in the administrative process, a problem not presented here. It also involved maintenance of the status quo rather than its alteration by imposition of new duties or reduction in rates for existing duties. However, the California Supreme Court has indicated serious doubts, at the very least, about *Gillespie's* correctness by ordering that it not be published in the official reports, thereby depriving it of any precedential effect. *Allstate Ins. Co. v. Gillespie*, No. S014332 (Cal. Feb. 21, 1991); *see* Cal. R. 977(a)(forbidding citation of unpublished opinions).

prima facie, such duties should not be imposed without *either* providing the rate adjustment necessary to obviate the confiscation shown *or* determining that contrary evidence rebuts the prima facie showing.

APPENDIX 12

ORDER NO.: A91-212

STATE OF NEW JERSEY
DEPARTMENT OF INSURANCE

IN THE MATTER OF THE JANUARY 17, 1991 RATE FILING BY THE MARKET TRANSITION FACILITY OF NEW JERSEY	))))	DECISION

The Market Transition Facility of New Jersey (MTF) submitted a rate filing to the Commissioner of the New Jersey Department of Insurance (Commissioner) on January 17, 1991. The filing proposed a number of changes to the existing MTF rating plan. According to this filing, approval of all the requested changes would raise the average MTF rate by 28%.

The following specific rating plan revisions were proposed on January 17, 1991,

a. the elimination of the Driver Improvement Program (DIP) and, in its place, the substitution of the Driving Record Debit Plan (DRDP);

b. the elimination of the second rating tier (Tier II) from the MTF rating plan;

c. a flex rate increase;

d. the introduction of various penalty fees to be charged in addition to the otherwise applicable premium; and,

e. a premium payment plan with six installments including upfront collection of the installment fees.

An amended version of the premium payment plan was submitted to the Commissioner on April 18, 1991. The revised plan maintained the number of payments (six) and the length of the plan (nine months), but changed the amount of the different installments.

Underlying the January 17, 1991 rate filing was an analysis of the rate increase necessary to bring the MTF to a breakeven financial condition. Two independent actuarial evaluations of the MTF's financial condition were obtained to provide this information. One, by William M. Mercer, Inc., (Mercer) was commissioned by the insurance industry under the auspices of the MTF Advisory Board's Actuarial Committee. The other, by Milliman & Robertson, Inc., (Milliman) was requested by the MTF itself.

The conclusion of the Milliman report, as stated in a November 2, 1990 letter to Mr. Lewis Roberts, an Assistant Commissioner in the Department of Insurance, was:

> . . . , we estimate that the rate level implemented for the MTF on October 1, 1990 was deficient by 62.2%. The indications by line show that virtually all of the inadequacy comes from the liability coverages which are deficient by 97.7% whereas the Physical Damage coverages are nearly adequate with a deficiency of only 6.0%.

The findings of the Mercer study were similar with the overall rate shortfall estimated to be 58.0%, based on a Liability coverage inadequacy of 88.5% and a Physical Damage deficiency of 7.5%.

The Department of Insurance began its review of the January 17, 1991 MTF rate filing shortly after its submission to the Commissioner. This process was completed recently. The determinations made hereinafter are based upon the following documents – (1) MTF Filing for Rate Revision, dated January 17, 1991; (2) Milliman & Robertson, Inc. report entitled "New Jersey Market Transition Facility: Analysis of Rate Level Needs as of October 1, 1990", dated November 2, 1990; (3) William M. Mercer, Inc. report entitled "New Jersey Private Passenger Automobile Market Transition Facility", dated November 14, 1990 – and the Department of Insurance staff evaluation of these documents.

I. MTF Physical Damage Coverage Rate Indication

According to both actuarial studies of the MTF, the current MTF physical damage coverage rates are close to adequate at the present time, at least on an overall basis. The specific indications estimated by Mercer and Milliman for these coverages were,

Coverage	Mercer	Milliman
Collision	- 1.0%	+4.4%
Comprehensive	+22.5%	+8.7%
Overall	+ 7.5%	+6.0%

However, in order to evaluate these recommendations properly, it is critical to review the accuracy of the assumptions underlying the calculations. This analysis can be found below.

a. Analysis of Mercer Physical Damage Indications

The Mercer overall physical damage coverage indication of a 7.5% rate increase is predicated on depopulation of the MTF. Specifically, Mercer has assumed an MTF market share of 35% in the fourth quarter of 1990, 29% in the first and second quarter of 1991. In actuality, the voluntary market has been depopulating the MTF at a slower rate than was assumed by Mercer.

On October 1, 1990, the MTF market share was 37.4%. The MTF's market share on January 1, 1991 was 36.4%. Recently, the Department received private passenger automobile insurance market share data for April 1, 1991. On that date, the MTF share of the market was 34.4%.

The Mercer report also contains an evaluation of how slower depopulation will affect the MTF's rate inadequacy. According to Mercer's own calculations, slower depopulation reduces the all coverage rate increase to 51.5%, a noticeable decrease from the original shortfall estimate of 58.0%. Because depopulation has occurred more slowly than Mercer assumed, a more accurate estimate of the physical damage coverage rate indications are the values from the Lesser Depopulation Effect analysis in the Mercer report. These amounts are,

Collision, -2.5% Comprehensive, +10.5%

The overall physical damage rate indication, assuming slower depopulation, is +2.5%.

b. Analysis of the Milliman Physical Damage Indications

The Milliman physical damage rate indication calculations also are based on overly optimistic assumptions about MTF market share. Milliman assumed a 32% market share for the first six months of MTF operation, a period which ended April 1, 1991. As noted above, the MTF insured a larger percentage of the market from October 1, 1990 through March 31, 1991.

The impact of slower than anticipated depopulation on the Milliman physical damage rate increase is somewhat unclear. As stated in the report, Milliman's findings do not reflect any worsening of MTF loss experience as a result of depopulation. However, the Milliman report does indicate that depopulation is expected to result in the MTF's losing its better-than-average insureds. Arguably, therefore, the absence of depopulation should not worsen the results and the Milliman estimates should be regarded as upper bounds on the required rate increase.

In calculating the indicated physical damage rate changes, Milliman has assumed a collision loss trend rate of 9.1% and a comprehensive loss trend amount of 10.5%. Mercer's trend values for these two coverages are lower, 7.0% for collision and 9.0% for comprehensive. The Milliman trend values appear overly cautious, given the choices that Mercer has made. Using the Milliman rate calculation methodology with the more reasonable trend rates recommended by Mercer, the Department staff has determined that the indicated physical damage rate indications would be,

Collision, -3.5% Comprehensive, +2.8%

When these individual coverage results are combined, the MTF physical damage rate indication is -1.1%.

Another concern is Milliman's use of the New Jersey Automobile Full Insurance Underwriting Association's (JUA) combined results for accident years 1985-1989 in calculating the MTF rate change indications. The indicated collision coverage rate inadequacy, for example, is substantially lower for accident years 1988 and 1989 combined (+0.5%) than for the 1985, 1986, and 1987 period (+7.3%). A similar result can be observed for the comprehensive coverage where the last two year rate inadequacy (+5.0%) is well below the deficiency for accident years 1985 through 1987 (+11.2%).

Given the apparent dissimilarity of the first three and last two years of the experience period, the five individual accident years probably should not be combined for the purpose of estimating the physical damage coverage rate needs of the MTF. And, by choosing to analyze the available data on an all accident year combined basis, Milliman may have overstated the MTF rate inadequacy for these two coverages.

c. Selected Physical Damage Rate Indications

Neither actuarial study of the MTF has indicated a need for a substantial physical damage rate increase on an overall or combined coverage basis under the conditions assumed in each of these reports.

It is evident, however, that depopulation of the MTF is occurring more slowly than anticipated by either Mercer

or Milliman. Slower than expected depopulation, according to Mercer, reduces the MTF's need for a physical damage rate increase. The Milliman report does not address this issue directly, but a reduced depopulation rate should not worsen the physical damage rate indications, because Milliman does expect that the best insureds in the residual market will be depopulated first.

The Milliman results also could overstate the MTF's collision and comprehensive rate needs because of excessively conservative assumptions about future loss trends. Another consideration in evaluating the Milliman findings is that the results are based on the JUA loss experience for the entire period 1985-1989, rather than only the latest two years when the indications were more favorable.

One actuarial study of the MTF's physical damage coverages indicates a small rate inadequacy while the other shows that these rates may be slightly too high. These same studies agree that collision rates may be somewhat more than adequate while comprehensive premium levels could be a little too low. In general, the indicated changes are not substantial for either coverage.

Given the general similarity of the two actuarial analyses, it is appropriate to use the average of the Mercer and Milliman results as the selected rate indications. These values are Collision, -3.0%, and Comprehensive, +6.7%.

II. MTF Liability Coverage Rate Indication

The Mercer and Milliman MTF actuarial studies contain the following rate level indications for the three different liability coverages:

Coverage	Mercer	Milliman
Bodily Injury	+ 77.5%	+ 93.9%
PIP	+177.0%	+173.0%
Property Damage	+ 35.5%	+ 31.2%
Overall	+ 88.5%	+ 97.7%

As before, the accuracy of the assumptions generating these numbers must be assessed in order to determine whether these indications should be accepted or not. This discussion can be found below.

a. Analysis of Mercer Liability Indications

As was the case for the physical damage coverages, the Mercer liability rate indications assume substantive depopulation of the MTF. Actual events have proven this assumption false and, by Mercer's own calculations, slower depopulation decreases the MTF's rate needs.

The Mercer liability coverage indications when depopulation of the MTF occurs more slowly than was assumed in the base case analysis are,

Bodily Injury, +69.5%
PIP, +166.0%
Property Damage, +34.5%
Overall, +81.5%

b. Analysis of Milliman Liability Indications

As discussed in Section I, there is no simple way to restate the Milliman results to reflect the MTF's greater than anticipated market share. However, the failure of the voluntary market to depopulate the MTF should reduce the otherwise indicated estimate of the liability rate shortfall by leaving more good drivers in the residual market than the Milliman analysis anticipated.

In developing the liability rate change indications, Milliman again appears to have been extra-conservative in the selection of the loss trend rates. A comparison of the selected trend factors from the two MTF actuarial studies is provided below.

Coverage	Mercer Trend Rate	Milliman Trend Rate
Bodily Injury	+ 6.5%	+10.8%
PIP	+ 9.0%	+15.1%
Property Damage	+ 7.0%	+ 9.0%

Substitution of the lower Mercer trend rate assumptions into the Milliman MTF financial model necessarily lowers the rate indications for each coverage. After making this change, the rate indications for the individual liability coverages are,

Bodily Injury, +66.9%
PIP, +121.9%
Property Damage, +22.6%
Overall, +69.3%

c. Selected Liability Rate Indications

After adjusting the liability coverage results in both MTF actuarial studies to recognize the true pace of depopulation and the expected loss trend rates, the overall liability rate indications are – Mercer, +81.5%, and Milliman, +69.3%. Although these two rate deficiency forecasts do differ, almost all of the variation is attributable to a disagreement about the estimated size of the PIP coverage rate shortfall.

Again, there is no specific reason to consider the findings of one study more "accurate" than those of the other. Accordingly, the average of the Mercer and Milliman liability rate shortfall values has been chosen as the selected indication for each coverage. The resulting figures are Bodily Injury, +68.2%, PIP, +144.0%, and Property Damage, +28.6%.

III. Other Rating Considerations

The selected rate indications in sections I and II above do not represent the only concerns relevant to the Commissioner in making a determination on the MTF Filing for Rate Revision dated January 17, 1991. These other considerations are discussed below and the rating impact of each issue is assessed as part of the Commissioner's evaluation of the MTF filing.

a. Elimination of the Tier II Rating

The January 17, 1991 filing is premised on several changes to the current MTF rating plan. One requested

revision is the elimination of the second MTF rating tier, more commonly known as "Tier II".

Tier II rates are charged to any MTF policyholder who has had (i) at least one at fault accident, (ii) two or more moving violations, or (iii) more than four motor vehicle points in the 36 month period preceding the policy effective date. All other MTF insureds are charged Tier I rates because of their demonstrably better driving record. The rationale of Tier II rating is to charge more to those insureds who cause or are expected to cause losses.

Section 40 of the Fair Automobile Insurance Reform Act of 1990 (FAIR Act) requires the Commissioner to promulgate a private passenger rating plan wherein the most important factor is the insured's driving safety record. The driving safety record is defined to include motor vehicle points, at fault accidents, and non-point producing moving violations.

The similarities between the Tier II rating rules and the language of FAIR Act Section 40 are striking. Given these similarities, the continued use of the Tier II rating differential is warranted. Accordingly, the MTF request for the elimination of Tier II is disapproved.

b. Elimination of DIP and Substitution of DRDP

Another requested change in the current MTF rating plan is the elimination of the DIP by substituting a similar system known as DRDP. The advantage of DRDP that is cited in the MTF rate filing is its "simplification" of the more complicated DIP. In addition, DRDP surcharges the rates to be paid by MTF insureds on the basis of the FAIR

Act eligibility point system recently promulgated by the Department of Insurance. Since the DIP is not based upon eligibility points, the substitution of the DRDP is appropriate.

However, the DRDP system cannot be approved as originally filed by the MTF. In its January 17, 1991 filing, the MTF proposed a DRDP in which an insured's premium rate would be increased by a specified percentage depending upon the number of eligibility points. The recommended percentage charges ranged from 0% for insureds with 0 eligibility points to 250% for drivers with 14 or more.

The Department has been informed by the Division of Law that the rate surcharge for an at fault accident must be a flat dollar amount, not a percentage charge, to be consistent with N.J.S.A. 17:29A-35. To conform with this requirement, the Department of Insurance staff has developed an amended DRDP for the MTF at the request of the Commissioner. In this revised plan, flat amounts were chosen to approximate what the percentage charge for at fault accidents would have been under the originally filed DRDP. These values are as indicated below.

At Fault Accident	Average Flat Charge
First, Second	$620
Third, subsequent	$420

In addition, the approved MTF DRDP will use a different schedule of percentage increase charges for non-accident related eligibility points. It was necessary to change the original eligibility point percentage change values to

reflect the fact that at fault accident charges must be flat dollar amounts. The new schedule of percentage charges for eligibility points that are not produced by at fault accidents can be found in Appendix A of this Order.

c. MTF Flex Rate Increase

The MTF has requested a 9.4% flex rate increase to offset anticipated inflationary effects on claim costs that affect both the voluntary and involuntary private passenger automobile market. This request is disapproved for the reasons indicated below.

Flex rating, as permitted by N.J.S.A. 17:20A-44, is limited to voluntary market insurers. The flex rate statute also specifies how the maximum permissible annual rate increase is to be calculated for each private passenger automobile coverage. In May of each year, the Department uses these rules to calculate the permissible rate increases for a one year period beginning July 1. This information then is transmitted by order to all private passenger automobile insurers.

Because the Department has not established the flex rate increase amounts for the period July 1, 1991 to June 30, 1992, the MTF's requested increase of 9.4% may be excessive. In addition, the proposed effective date, April 1, is prior to July 1. Finally, the MTF is not a voluntary market insurer and it is not entitled to make use of the provisions of N.J.S.A. 17:29A-44. For all of these reasons, the Commissioner cannot grant the MTF's flex rate increase request.

d. Introduction of Penalty Fees

The MTF rate filing requests the ability to impose penalty fees on its insureds for various violations not included in its DRDP. These charges are for activities such as loaning or borrowing a driver's license, allowing an unlicensed driver to operate the vehicle, or using a vehicle without the permission of the owner.

All of the violations generating penalty fees do reflect negatively on the insured's driving safety record. Accordingly, the MTF penalty fee schedule is approved. However, because the MTF filing does not show any rate impact from the adoption of the penalty fee schedule, none is assumed in this determination.

e. Amendment to the MTF Premium Payment Plan

The MTF has sought approval to change its current premium payment plan from a six month, four installment program to one with six installments paid over nine months. As required by N.J.S.A. 17:33B-11(c)(6), the MTF must have an installment payment plan with a period of not less than nine months.

The original proposal for a six payment, nine month plan satisfies this requirement. On April 18, 1991, the MTF filed an amendment to its payment plan proposal reducing the amount of the initial installment and slightly increasing the size of the latter payments. The number of payments, the length of the plan, and the upfront collection of installment fees were not changed. Accordingly,

the revised MTF payment plan still satisfies the requirements of N.J.S.A. 17:33B-11(c)(6) and the April 18, 1991 payment plan is hereby approved.

Neither the original MTF rate revision request nor the April 18, 1991 filing indicate any rate impact from the approval of a six installment, nine month premium payment plan. Consequently, no rate impact is assumed in this determination.

IV. Financial Impact of the Approved MTF Rating Plan Changes

The January 17, 1991 MTF Filing for Rate Revision proposed various changes in the current MTF rating program. According to that filing, the approval of all the requested changes would result in an overall rate increase of 28%. It has been necessary, for the reasons given in Section III above, to reject or to amend some parts of the MTF rate revision request. The approved MTF rating plan will contain the following elements:

A. a set of Tier I rates;

b. a set of Tier II rates;

c. at fault accident surcharges;

d. rate surcharges depending upon events other than at fault accidents; and,

e. a six installment, nine month premium payment plan.

The Department of Insurance staff has been asked by the Commissioner to analyze the financial impact of this rating plan because elements b, c, and d differ from the original MTF rate revision proposal. Based upon a review

of approximately 4,000 MTF policies, the Department's actuaries have calculated that the new MTF rating plan will produce an 18.6% increase in MTF revenues.

V. The Need for an Additional MTF Rate Increase

a. Actuarial Evaluation of MTF Rate Adequacy

Two different actuarial firms, William M. Mercer, Inc. and Milliman & Robertson, Inc., had estimated the overall MTF rate deficiency to be about 60%. It already has been determined that both of these studies overestimated the MTF's rate needs by inaccurately forecasting the pace of depopulation. After adjusting the calculations to reflect actual MTF depopulation and other considerations, the Mercer estimate of the required rate increase drops to 51.5% and Milliman's is reduced to 43.3%.

The average of the Mercer and Milliman indications is 47.4%. If the MTF does require a rate increase of this size, the decisions (1) to retain Tier II rating, and (2) to substitute the amended version of DRDP for DIP rating will provide some of the necessary funds. The approved changes to the MTF rating plan are expected to generate 18.6% more premium dollars. Nevertheless, the actuarial evaluations appear to indicate that the MTF needs a further rate increase of 24.3% (1.474/1.186 = 1.243) to reach a breakeven financial position.

b. The Accuracy of the MTF Actuarial Evaluations

Critics of this decision probably will use the two MTF actuarial studies to claim that the Department has

underfunded the MTF deliberately. There are several reasons, however, to question whether the actuarial estimates of the MTF rate needs are accurate. Foremost amongst these issues is the actuaries' reliance on JUA data to forecast MTF results.

i. Use of JUA Data: Questions about the credibility of the actuarial findings can be raised, for example, because of the January 1, 1989 introduction of the verbal threshold and the PIP deductibles. The MTF actuarial evaluations include only one year of JUA experience with these coverage changes. Unfortunately, bodily injury and PIP losses take a relatively long time to develop. One year of experience may represent an insufficient basis from which to determine the rate effect of the verbal threshold and the PIP deductibles.

The potential for new programs or coverage changes to improve loss experience is demonstrated by recent JUA physical damage loss experience. As part of the automobile insurance reforms introduced on January 1, 1989, the standard physical damage coverage deductible was raised to $500. Collision and comprehensive claims settle much more quickly than bodily injury and PIP liability losses, making the JUA physical damage data a somewhat better basis for judging the effect of the 1989 coverage changes. As shown in the Milliman report, the best JUA results for both collision and comprehensive were produced in 1989, after the standard deductible was increased.

The passage of the FAIR Act in early 1990 raises additional questions about the propriety of using JUA data to forecast MTF results. The FAIR Act has changed the

mechanics of the New Jersey private passenger automobile market by providing new coverage options and imposing additional duties on insurers. Two examples of such changes are the health insurance primary PIP option and the mandatory physical damage inspection program. At this time, one can only speculate what savings will be generated by these initiatives.

ii. Operational Differences between the JUA and the MTF: The issue of whether JUA experience is a proper basis for estimating MTF financial needs also can be raised from an operating perspective.

The MTF has four servicing carriers, all of whom are handling relatively large volumes of business and are carry-over JUA servicing carriers. The JUA originally had 15 servicing carriers, three of whom discontinued operations after a short period. Then, the remaining 12 servicing carriers were replaced by five others, four of whom had not handled JUA business previously. The most inefficient of these five did not continue as an MTF servicing carrier.

The JUA began operation in 1984. By early 1985, the JUA share of the New Jersey private passenger automobile market was approximately 40%. The JUA continued to grow slowly until, in mid-1988, about 50% of all New Jersey drivers were insured by the JUA. On September 30, 1990 when the JUA stopped writing business, its market share was still 37.4%.

The MTF's market share, in contrast, probably will peak at less than 35% on September 30, 1991 and could be as low as 10% on September 30, 1992 when the MTF closes its doors. Clearly, the JUA had a much more stable book

of business than the MTF will. Given this difference, it is reasonable to question whether the experience of the MTF will be comparable to that of the JUA.

iii. Other Rate Related Issues: It also is important to recognize that the MTF will continue to write business for another 16 months. The length of this period does provide the MTF with ample time to make another rate application to the Commissioner if its financial results are as poor as the actuaries are predicting.

c. Selected MTF Rate Change Amount

There is substantial uncertainty about depopulation and, correspondingly, the performance of the MTF. The actuarial analyses are based solely on the experience of the JUA, not the MTF. The MTF financial results probably will be better than those of the JUA because of operating efficiencies and changes in the law that will affect claim payments. Finally, the MTF has the ability to apply for further rate relief whenever its actual financial results warrant such a request.

For all of the above reasons, only the retention of Tier II rating and the introduction of DRDP, as amended by the Commissioner, will be approved for use by the MTF at this time. However, as evidence of the Department's commitment to operate the MTF on a no profit, no loss basis, the MTF will be asked to provide quarterly statements of its financial position. Such statements will include actual current results as well as projections for future quarters.

If the MTF certifies or the Department staff determine that the actual results are significantly worse than the

previously projected values, this information will be viewed by the Commissioner as an "early warning" of a potential MTF rate deficiency. The Commissioner, upon receiving a quarterly report showing significant deterioration in the MTF financial results, will order the MTF to prepare an actuarial evaluation of its rate needs that will serve as the basis for approving an appropriate MTF rate increase.

Upon the full review by the Department of Insurance, it is ordered on this 10th day of May 1991, that:

(1) the MTF request for the elimination of Tier II rates from its current rating program is disapproved;

(2) the MTF request for the elimination of DIP rating is approved;

(3) the MTF request for the introduction of DRDP rating, as amended by the Commissioner, is approved;

(4) the MTF request for a flex rate increase is disapproved;

(5) the MTF request for the use of a nine month, six installment premium payment plan is approved as filed on April 18, 1991; and,

(6) all MTF new and renewal business with effective dates on or after June 15, 1991 shall be subject to rates determined according to the rating program hereinabove approved.

In addition, the MTF is ordered to provide the Commissioner with a quarterly statement of its financial position, including such operating information as income, expenses, loss payments, loss reserves, and cash flow. As the purpose of these quarterly statements is to allow the

Department and the Commissioner to monitor the financial status of the MTF, the operating statement shall include the projected values for future periods as well as the actual current period results.

This Order constitutes a final agency decision and is effective immediately. Any appeals from this Order must be filed in the Appellate Division within 45 days of the date of the Order.

DATED: 5/10/91 /s/ Samuel F. Fortunato
Samuel F. Fortunato
Commissioner

QA/mtfrat91.det

APPENDIX A

DRDP Eligibility Point Rating Factors

No. of Eligibility Points *	Rating Factor **
0	1.00
1	1.49
2	1.20
3	1.59
4	1.49
5	1.41
6	1.59
7	2.12
8	1.88
9	2.20
10	2.13
11	1.85
12	2.59
13	2.09
14	2.59
15	2.50
16	1.93
17	2.92
18	2.25
19	2.92
20	2.80
21	2.68
22 or more	2.90

* In determining the applicable rating factor, no eligibility points are assigned to at fault accidents. Flat charges for at fault accidents are imposed separately under the MTF DRDP.

** The selected rating factors produce gradual growth in the rate increase amount as the number of eligibility points goes from 1-9, considering the rates currently paid under DIP. For insureds with 10 or more eligibility points, the rate increase is the same as for those with 9 points.

APPENDIX 13

NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE COMMITTEE ON OPINIONS

SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION A-4634-90T5

(Filed Nov. 19, 1991)

IN THE MATTER OF THE COMMISSIONER OF INSURANCE'S MAY 10, 1991 ORDERS REGARDING THE JANUARY 17, 1991 RATE FILING BY THE MARKET TRANSITION FACILITY OF NEW JERSEY.

The opinion of the court was delivered by

COHEN, R.S., J.A.D.

Allstate Insurance Company appeals two orders of the Commissioner of Insurance. The first is the order denying Allstate a role in the proceedings leading to the order setting auto insurance premiums of the Market Transition Facility ("MTF"). The second is the Commissioner's MTF rate order itself. Two other insurers, Aetna Casualty and Surety Company and Liberty Mutual Insurance Company, also appealed the Commissioner's rate order. A-4844-90T5 and A-5298-90T5. Their appeals were stayed on the Commissioner's motion, pending disposition of the present appeal. We reverse the order excluding Allstate from the rate-setting process and order the Commissioner to take immediate action to set proper MTF rates.

The dispute arises out of New Jersey's perennially troubled auto insurance market. The background was thoroughly explored in *State Farm Mut. Auto. Ins. Co. v. State*, 124 *N.J.* 32 (1991). *See also in re Assignment of Exposures*, 248 *N.J. Super.*

367 (App. Div.), *certif. denied*, ___ *N.J.* ___ (1991), and *Allstate Ins. Co. v. Fortunato*, 248 *N.J. Super.* 153 (App. Div. 1991). The present case requires us to review some of the history.

In 1983, the New Jersey Automobile Full Insurance Availability Act was adopted. *N.J.S.A.* 17:30E-1 *et seq.* Its principal purpose was to assure access to automobile insurance at standard market rates to qualified persons who could not otherwise obtain insurance. *N.J.S.A.* 17:30E-2. The Act replaced the assigned risk plan, created by *N.J.S.A.* 17:29D-1, with a new residual market mechanism, which came to be called the "Joint Underwriting Association" or "JUA," and which was to offer policies to drivers rejected by the voluntary market. In the late 1980s, despite periodic legislative efforts to provide financial relief, JUA was in deep financial trouble. Private insurers had steadily reduced their market share, and willingly covered only the best risks. JUA had to take on more and more high-risk drivers, urban drivers, young drivers and others whom the insurers, for good reason or bad, rejected. Ultimately, half of New Jersey's drivers were insured by JUA. The insurers blamed the Commissioner's refusal to permit them to charge sufficient premiums for high-risk private business. The Commissioner consistently denied rate relief. Although many of JUA's insureds were safe drivers, its population included the bulk of the State's worst risks.

JUA was required to cover risks rejected by the voluntary market, but it could charge them no more than standard market premium rates. JUA would therefore suffer losses in the absence of revenue supplements. Additional funds were expected to be raised from bad-driver and accident surcharges imposed by the Division

of Motor Vehicles and JUA, and the "residual market equalization charge" ("RMEC"), which was to be laid equally on all autos insured in the voluntary and residual markets except those with principal drivers aged 65 years or older. The RMECs were required to be periodically set by the Commissioner. *N.J.S.A.* 17:30E-8a, at a level that would permit JUA to operate on a break-even, no profit, no loss basis. *N.J.S.A.* 17:30E-3o; *State Farm, supra* 124 *N.J.* at 41-42; *In re Assignment of Exposures, supra,* 248 *N.J. Super.* at 372-373.

A number of statutory changes took effect in 1988 in an effort to reduce the cost of auto insurance generally, and to reverse the deteriorating condition of JUA in particular. The legislative goal of providing full access to auto insurance at standard rates was modified by permitting JUA to charge bad drivers 10% annual increases for four years. *N.J.S.A.* 17:30E-2, -13a to -13d. There was an optional verbal threshold for tort actions, *N.J.S.A.* 39:6A-8, -8.1, flex rating for insurers, *N.J.S.A.* 17:29A-44, an insurers' excess profits law, *N.J.S.A.* 17:29A-5.6 *et seq.*, an authorization for JUA to defer payments of bodily injury losses when JUA income is insufficient to meet its obligations, *N.J.S.A.* 17:30E-8.1, a multi-tier rating system for the voluntary market, reflecting the worst risks, *N.J.S.A.* 17:29A-45, and a program for the audit of JUA's servicing carriers to find, recover, and penalize any overcharges made by them to JUA, *N.J.S.A.* 17:30E-17.1.

Most importantly, the 1988 changes provided for the depopulation of JUA over four years, leaving only the least desirable risks for it to cover, *N.J.S.A.* 17:30E-14, and those would be charged self-sustaining, unsubsidized rates. Enough JUA insureds would be periodically assigned to the voluntary market to assure that it would

absorb and cover 60%, 70%, 75% and then 80% of the market during the four years of depopulation. *In re Assignment of Exposures, supra,* 248 *N.J. Super.* at 374. The 1988 amendments did not solve the problems.

On March 12, 1990, the Fair Automobile Insurance Reform Act of 1990 ("FAIR Act") became effective. *L.* 1990, *c.* 8. It imposed surtaxes and assessments on the private insurers and fees to be collected from doctors, lawyers and auto body shops. The proceeds were intended to pay JUA's accumulated debt of more than $3.3 billion over a period of time. *See State Farm, supra,* 124 *N.J.* at 42; *Allstate, supra,* 248 *N.J. Super.* 153 (App. Div. 1991).

The FAIR Act also abandoned JUA as a residual market mechanism, and created MTF. MTF was to gradually take on the risks whose JUA policies expired after September 30, 1990, and was to issue its own policies for two years, until October 1, 1992. During that time, the MTF population would be reduced, if necessary by periodic assignments of risks to insurers who did not voluntarily take on their share, to 32%, 29%, 20% and, finally 10% of the market. The 10% residuum of rejected risks would be relegated to the old assigned risk plan. *N.J.S.A.* 17:33B-11c(5); 17:29D-1.

MTF's initial premiums were to be based on JUA's insufficient September 30, 1990 rates. However, its short revenues, unlike JUA's, would not be supplemented with RMECs, surcharges, assessments and professional fees. (RMECs and policy constants had grown to about a third of all JUA revenues.) MTF's profits and losses would be apportioned among the auto insurers. *N.J.S.A.* 17:33B-11d. *In re Assignment of Exposures, supra,* 248 *N.J. Super.* at 375.

When private insurers took on JUA/MTF risks as part of the depopulation program, they could charge them their ordinary premium rates, or, if they chose to do so, they could charge MTF rates. *N.J.S.A.* 17:33B-12. MTF rates were higher then those of many insurers, including Allstate. In May 1991, when the Commissioner was considering MTF's rates, we heard insurers' objections to the Commissioner's January 1991 depopulation order on the ground that their premiums were too low for the new business. *In re Assignment of Exposures, supra,* 248 *N.J. Super.* 367. We concluded that the insurers' opportunity to use MTF rates for depopulation business meant that they were not being forced to take on hundreds of thousands of new, higher risks at voluntary market rates.[1] We said:

> Current MTF rates are higher than the current voluntary market rates of Aetna and Allstate, and, we assume, also of Colonial Penn. In addition, MTF rates will be supplemented for substandard drivers who are still eligible for assignment. The supplement may not be as great as the insurers think will be necessary, but that is very difficult to evaluate now. Moreover, MTF has already applied to the Commissioner for a 28% rate hike, approval of which would further increase premium levels. Not enough, say the insurers, pointing out that MTF has announced that its rates need a 60% increase to permit MTF to break even; insurers are entitled to earn a profit, and MTF's break-even rates are therefore inadequate by definition. [248 *N.J. Super.* at 389].

---

[1] Allstate was assigned some 30,000 policies in the January 24, 1991, depopulation order. It says it will be required to accept an additional 270,000 exposures to meet its remaining depopulation obligations.

We ultimately concluded:

> The insurers will be able to charge the recently enhanced MTF rates to their assigned exposures. That creates a better situation than was predicted for the insurers at the time of their briefs and oral arguments. Whether it is better enough would no doubt be the subject of some disagreement. We are in no position, however, to predict whether that untested new business taken on by the insurers from MTF at untested new MTF premium rates will result in future losses so clear and significant that the insurers are entitled to protection in advance. [248 *N.J. Super.* at 390].

MTF began issuing policies and charging premiums on October 1, 1990. The FAIR Act required it initially to use JUA rates, with a few exceptions and variations. *N.J.S.A.* 17:33B-11c(2). The Commissioner had the authority, however, to raise rates. *N.J.S.A.* 17:33B-11c(3). It must have been apparent to the Commissioner, as the operator of MTF, that the JUA rates were too low. They were so low in the late 1980s that even cash flow accounting, RMECs, bad-driver increases and other revenue enhancers did not prevent dramatic yearly deficits. The anticipated greater accountability and efficiency of MTF, limitation of generous policy benefits, and other cost containment measures could be expected to accomplish just so much. The loss of RMECs would be a tremendous loss of revenue, and there were no means provided in the FAIR Act to subsidize residual market premium rates.

In November 1990, MTF received the reports of two actuarial consulting firms which had been retained to study the appropriate level of MTF rates. One firm Milliman & Robertson, Inc. ("Milliman") had been retained by the Department of Insurance itself, through MTF. The

other, William M. Mercer, Inc. ("Mercer") had been brought in by the insurance industry through the MTF Advisory Board's Actuarial Committee. (The Advisory Board is a statutory body without operational authority whose members are appointed by the Commissioner of Insurance, largely from the insurance field. *N.J.S.A.* 17:33B-11b.)

The conclusions of the two reports were quite similar. Milliman estimated that overall MTF rates were "deficient by 62.2%" on the day it opened for business: liability coverages were 97.7% low, and physical damage coverages were 6.0% low. Mercer concluded that the MTF deficiency was 58.0%, with liability coverages 88.5% low, and physical damage coverages 7.5% low.

Although the actuarial consultants both reported in the first half of November 1990 that MTF rates were grossly inadequate, the Special Deputy Commissioner of Insurance in charge of MTF did not ask the Commissioner for higher rates until January 17, 1991, when he formally submitted his "Filing for Rate Revision." The Commissioner studied the matter for another four months, and made his decision on May 10. MTF had by then been operating for more than 7 months with rates that were plainly and obviously too low. The Attorney General represented at oral argument that the only communications between the Commissioner and his Deputy on the subject were the official January 17 application for premium increases and the Commissioner's May 10 response. The reason we were given was that the Commissioner wanted to avoid the appearance of impropriety.

The Deputy did not apply for the 62% or 58% increase the actuarial consultants said was necessary. Instead, he asked for an overall additional 28%. He did

not tell the Commissioner he thought that an additional 28% would be enough to break even. Instead, he said:

> The reason it is less than the indicated need is that any other amount would have required a large increase that would have impacted the clean driver.

Along with his "Filing," the Deputy sent copies of the two actuarial studies and a letter from the MTF Actuarial Committee describing the consequences of insufficient MTF premium rates. As far as we know, there were no other materials sent to the Commissioner. His review consisted of analyzing the reliability of the assumptions, methodologies, and conclusions of the actuaries. The Commissioner had no countervailing information that we know of, except what little he mentioned in his opinion.

In March, while the Commissioner was studying the materials submitted to him, Allstate applied for leave to intervene, only to file a brief urging that the requested 28% was not enough. It cited Administrative Code rules permitting interested parties to intervene in "contested cases." *See N.J.A.C.* 1:1-16.1 *et seq.* It said it was prepared to rely on the record provided by the actuarial reports and the January 17 letter of the Deputy; it would seek to present additional evidence only if the record was to be supplemented or expanded.

The Commissioner denied Allstate's application, but only on the day he made his rate determination. He said that there was no "contested case," and therefore Allstate's reliance on rules for intervention in contested cases was misplaced. He said that setting MTF rates was part of his authority as the operator of MTF, and was not the occasion for an adversary proceeding. He further stated

that the proposed intervention "would delay an expeditious decision," and that the MTF Advisory Board requested that there be no delay, but that Allstate's application for higher MTF rates proceed independently at Allstate's expense.

The Commissioner issued a 25-page opinion explaining his disposition of MTF's filing. The opinion first dealt with physical damage coverage premiums, which the consultants had evaluated as 6% (Milliman) and 7.5% (Mercer) too low. The Commissioner found that both evaluations were based on unrealistic assumptions about the pace of MTF depopulation. On the basis of the first six months of operation, the Commissioner found that depopulation was proceeding more slowly than the actuaries had predicted. He apparently assumed that the first drivers to leave MTF in the depopulation were the lowest risk drivers; thus, slower depopulation dampened the rise in average risk levels for the drivers still covered. Mercer shared this assumption. Milliman did not.

The Commissioner had additional concerns: Milliman's predicted loss trends of about 10% for collision and comprehensive coverages were too high; the use of JUA loss figures was misleading. At the bottom line, the Commissioner concluded that the actuaries' predicted deficiencies in physical damage premiums should be reduced to -3% for collision and 6.7% for comprehensive coverage.

The actuaries' liability coverages deficiency estimates were:

	MERCER	MILLIMAN
Bodily Injury	77.5%	93.9%
PIP	177.0%	173.0%
Property Damage	35.5%	31.2%
Overall	88.5%	97.7%

The Commissioner concluded that these numbers were too high because depopulation was slower than expected, because Milliman's loss trend rates were too high, and because MTF proposed certain changes that would cost money and which the Commissioner had disapproved.[2] The Commissioner stated that the actuaries' predictions had to be adjusted for their forecasting inaccuracies. Without identifying the magnitude of the inaccuracies, he reduced the overall Mercer estimate from 58% to 51.5% and Milliman's from 62.2% to 43.3%. The average of the two was 47.4%.

The rating plan which the Commissioner approved would produce an 18.6% increase in MTF revenues. Adjustments in the rating plan would produce further revenues which the Commissioner did not estimate, but he ultimately recognized that the actuarial evaluations appeared to indicate the need for an additional 24.3% to break even. He then commented:

> Critics of this decision probably will use the two MTF actuarial studies to claim that the Department has underfunded the MTF deliberately. There are several reasons, however, to question whether the actuarial estimates of the MTF rate needs are accurate.

Again, the Commissioner questioned the use of JUA data to forecast MTF results: lower benefit payouts could be anticipated, along with more efficient operations and lower costs resulting from differences in the mix of JUA

---

[2] The relevance of this information is not clear, since the actuaries did not base their November 1990 projections on changes MTF proposed in January 1991 for adoption some months later.

and MTF insureds in the smaller share of the insured population covered by MTF. The Commissioner did not say why the smaller share should result in lower-than-anticipated deficits. Indeed, if the smaller share results from early depopulation of the better drivers, as he earlier posited, the smaller share would have a greater component of higher risks.

Finally, the Commissioner expressed his Department's "commitment to operate one MTF on a no profit, no loss basis," and stated that MTF had "ample time to make another rate application . . . if its financial results are as poor as the actuaries are predicting." He continued:

> If the MTF certifies or the Department staff determine that the actual results are significantly worse than the previously projected values, this information will be viewed by the Commissioner as an "early warning" of a potential MTF rate deficiency. The Commissioner, upon receiving a quarterly report showing significant deterioration in the MTF financial results, will order the MTF to prepare an actuarial evaluation of its rate needs that will serve as the basis for approving an appropriate MTF rate increase.

The Commissioner therefore told MTF to provide him with quarterly statements of its financial position, including actual current results as well as projections for future quarters, showing income, expenses, loss payments, loss reserves, and cash flow.

Evaluation of the Commissioner's rate order and refusal to let Allstate participate has to include an

analysis of the differences between MTF and its predecessor, JUA. JUA was an unincorporated non-profit association of all New Jersey auto insurers. *N.J.S.A.* 17:30E-4. It had a board of directors of 17 members,[3] 14 appointed by the Governor, one each by the President of the Senate and the Speaker of the Assembly, and, *ex officio* the Director of the Division of Motor Vehicles. The insurance industry was well represented on the Board, *N.J.S.A.* 17:30E-5a. It was to adopt a plan of operation, subject to the Commissioner's approval. *N.J.S.A.* 17:30E-6. JUA was granted broad operating authority, to be exercised by the Board and a general manager who reported to the Board and not to the Commissioner.[4] *N.J.S.A.* 17:30E-7. The Board was sufficiently independent to litigate with the Commissioner over the imposition of RMECs. *See New Jersey Auto. Full Ins. Underwriting Ass'n v. Gluck*, No. A-4870-84T1 (App. Div. June 19, 1986). JUA's sources of income have already been described, as has its express obligation to operate on a break-even basis by the exaction of sufficient RMECs from the policyholders. The insurers were not responsible for JUA losses.

The JUA statute has a detailed provision for mandatory hearings to be conducted by a panel of the Board on the request of a member insurer aggrieved by a ruling of JUA, or its failure to adhere to its plan of operation, or to the enabling statute. The Board's ruling was appealable

---

[3] Later reduced to 9 members. *L.* 1988, *c.* 119, § 17.

[4] In 1986, the Legislature declined to enact a proposed amendment to have the general manager report to the Commissioner instead of the Board.

to the Commissioner and then to this court. *N.J.S.A.* 17:30E-16.

MTF's statute is different. *N.J.S.A.* 17:33B-11 creates MTF, "to be operated by the Commissioner of Insurance pursuant to the provisions of this section." It does not describe MTF as an unincorporated non-profit association of auto insurers or any other kind of entity. It merely says the auto insurers shall be members of MTF "and shall share in its profits and losses." *N.J.S.A.* 17:33B-11a. There is no board of directors or general manager reporting to it, but only an advisory board. *N.J.S.A.* 17:33B-11b. There is no express provision for rate subsidies or break-even operation, or for hearings at the request of an aggrieved insurer. There is no person or board empowered to confront the Commissioner regarding MTF operations.

JUA was structured as an entity with a chief executive and board of directors who functioned somewhat independently. The consumers' and the insurers' interests were protected by representation on the Board. Premiums were set by the voluntary market. The Commissioner had ultimate financial control because the imposition of RMECs was his responsibility. He had the obligation, however, to set the RMECs high enough to cause JUA to operate on a no profit, no loss basis. *N.J.S.A.* 17:30E-3o. The point is that, with that very significant exception, JUA was not the Commissioner's direct responsibility.

MTF, on the other hand, is the Commissioner's operation. He may, of course, designate subordinates for day-to-day functions. The Commissioner is not, however, a neutral sometime referee for an insurance mechanism

operated by others. As the Commissioner said in rejecting Allstate's motion to intervene:

> The Legislature directed that the MTF is "to be operated by the Commissioner. . . . " Thus the determination fixing rates for MTF is a matter solely within the scope of the Commissioner's powers.

The other salient difference between JUA and MTF is the matter of deficits. The Legislature told the Commissioner to see to it that JUA broke even. It did not contemplate that he would not do so; it provided no means to pay a deficit. Only later, after JUA ran up a $3.3 billion deficit, was legislation enacted to deal with it.

The FAIR Act does not expressly require MTF to be a break-even operation, but the law cannot be otherwise. If there were no such requirement, the Commissioner could purposely set rates high enough to yield a profit, which he could then distribute to the member insurers. There is, however, nothing in the text or purpose of the FAIR Act that entitles the Commissioner to operate MTF to make a profit. It is unthinkable, not only as a matter of policy but also as a matter of law, that the Commissioner might plan such a windfall for insurers at the expense of policyholders.

It is equally unthinkable to suggest that the Commissioner could decide, as a matter of policy, to select deficit rates, and later send apportioned bills to the member insurers. The statute does not expressly confer such a power to tax the insurance companies. There is no

obvious method for them to pass the cost on.[5] The Commissioner did not argue in his May 10, 1991 opinion or before us on appeal that he has such authority. Indeed, he expressed his "commitment to operate the MTF on a no profit, no loss basis. . . . "

When the Legislature wanted to impose financial burdens on the insurance companies in the FAIR Act, it knew how to do so in plain terms. For example, it levied assessments and surtaxes designed to pay off JUA's accumulated debt. *N.J.S.A.* 17:30A-8a(9) and (10), 17:33B-49. The assessments cannot be passed along, dollar for dollar, to the policyholders. *N.J.S.A.* 17:30A-16b. Also, the Commissioner is to ensure that policyholders do not pay for the surtax. *N.J.S.A.* 17:33B-51. In *State Farm*, the Supreme Court read the FAIR Act to bar direct pass-throughs of assessments and surtaxes, but said they were not unlawful on their face, on the assumption that the Commissioner would fulfill his duty to see to it that the insurers would receive a constitutionally fair overall rate of return, *see Sheeran v. Nationwide Mut. Ins. Co., Inc.*, 80 *N.J.* 548, 560 (1979), and that he would act in a realistic and timely manner consistent with that statutory duty. *State Farm, supra*, 124 *N.J.* at 62-63.

The Commissioner does not make the argument that prevailed in *State Farm*. He does not contend that the statute authorizes him to run MTF at a loss to the

---

[5] We were told at oral argument that the Commissioner does not plan to send bills to the insurers until 1993. It is not clear exactly how they would be able to recoup the expenses at that late date.

insurers; with the insurers' right to a fair return authorizing them to pass along the costs only if necessary to prevent an unconstitutional taking. In his opinion, the Commissioner expressed his "commitment to operate the MTF on a no profit, no loss basis." In his brief before us, he describes his "dedication" to that proposition "in fulfillment of his perception of the legislative intent."

The question before us is not the one decided in *State Farm*. There, it was clear that the Legislature had imposed financial burdens on the insurers, and the Supreme Court had to determine the constitutionality of the imposition. Here, the question is whether the Legislature, by saying that the insurers share MTF's profits and losses, but without any operating role, has authorized the Commissioner to set MTF rates at a loss-producing level. Although he does not argue that he has that authority, it is useful to rule clearly that he does not.

We defer to reasonable exercises of administrative agency expertise. *Henry v. Rahway State Prison*, 81 *N.J.* 571, 579-80 (1980). We recognize the Insurance Department's familiarity with the operations of the auto insurance market. *IFA Ins. Co. v. New Jersey Dep't of Ins.*, 195 *N.J. Super.* 200, 206-07 (App. Div.), *certif. denied*, 99 *N.J.* 218 (1984). We do not have to deal, however, with a contested agency interpretation of its enabling statute. *See Smith v. Director, Div. of Taxation*, 108 *N.J.* 19 (1987). And that is because the Commissioner's view coincides with Allstate's and our own: his duty is to operate MTF on a break-even basis. We repeat that there is no disagreement on that score, and no contention that the insurers must pay up and hope for later rescue in a constitutional safety net.

When the Commissioner sets MTF rates, it is not necessary for him to act as a neutral adjudicator of his Deputy's presentations or even of cases made by opposing parties. That is the Board-of-Public-Utilities model, and it does not fit very well. The Commissioner is the chief executive and operating officer of MTF, and he chose a Deputy to run it on a daily basis. The Commissioner surely has no need to avoid discussing rates with his Deputy to avoid the appearance of impropriety. The Deputy is his subordinate, and runs MTF in his name. That does not mean, however, that the Commissioner may set MTF rates in a closed-door process from which those affected are completely excluded.

The March 12, 1990 statute directed the Commissioner to adopt procedures for "the filing and approval of changes in [MTF] rates . . . " *N.J.S.A.* 17:33B-11c(3). He did not do that. If he had done so, he might have followed the BPU model, at least to the extent of erecting the framework for an adversary process that included plenary presentation of evidence. He might instead have followed the rule-making model, in which he would have published proposed rates and subjected them to public scrutiny and comment by affected parties before deciding whether to adopt them. *See State, Dep't of Envtl. Protection v. Stavola*, 103 *N.J.* 425 (1986); and Justice Handler's dissent, *id.* at 439; *Metromedia, Inc. v. Director, Div. of Taxation*, 97 *N.J.* 313 (1984). We call the Commissioner's attention to *Bally Mfg. Corp. v. New Jersey Casino Control Comm'n*, 85 *N.J.* 325 (1981), *appeal dismissed*, 454 *U.S.* 804, 70 *L. Ed.*2d 74 (1981), and particularly to Justice Handler's concurring opinion, *id.* at 337.

The intersection between agency adjudication and rule-making functions is, as the cited cases show, not always an easy one to locate. It is not for us to make an initial determination whether one process or the other is more suitable, or even exclusively suitable, to deal with MTF ratemaking. What can safely be said, however, is that some process must be devised and employed that will take adequate account of the fact that MTF ratemaking decisions dispose of hundreds of millions of dollars of somebody else's money. Such decisions cannot be made behind closed doors, out of the sight of the people affected and without the benefit of any input from them.

Since the Commissioner did not follow the statutes's direction to adopt procedures for MTF ratemaking, we have no opportunity to evaluate adopted procedures. It would, however, be inappropriate for us to select a particular path for the Commissioner to follow. There are many possibilities, and it is for him to choose among them. The problem is that time is passing rapidly and, perhaps, irretrievably.

In his May 10 rate order, the Commissioner said that monitoring actual MTF operations would permit him to see if the actuaries' forecasts were accurate or, as he then believed, unduly pessimistic. If they were accurate, he could consider raising MTF rates. It is now thirteen months since MTF opened for business, and six months since MTF's rates were raised 18.6%. The first quarterly report the Commissioner asked his Deputy for will not, we are told, be ready until late December. And, that is not a firm date. We are not intimately familiar with the Department's records of MTF operations. We are unaware, however, of any actions being taken by the

unaware, however, of any actions being taken by the Commissioner to test the validity of his May 10 skepticism regarding the actuaries' forecasts. It is apparent that an immediate and assiduous search for guidance in the available records of MTF experience would enable the Commissioner to better evaluate his May 10 forecasts and the actuaries', and to make appropriate plans for the future.

The Commissioner is faced not only with the possibility of creating tremendous MTF losses by permitting operations at insufficient rates, but also the possibility of creating additional losses for private insurers on voluntary business written at MTF rates for depopulated risks. And yet, the timetable he set in his May 10 order for "early warning" of potential deficits depended on quarterly reports from MTF, the first one of which is not expected to be complete until late December. Then, the Commissioner may order MTF "to prepare an actuarial evaluation of its rate needs", and then a rate increase will be considered. The problem, of course, is that the time for charging increased premiums grows shorter every day, and will soon disappear altogether. We note that the Commissioner had the duty to approve or disapprove a JUA filing for increased RMECs within 60 days. Inaction constituted an approval. *N.J.S.A.* 17:30E-8b.

Rate hikes are prospective only. *In re Petition of Elizabethtown Water Co.*, 107 *N.J.* 440, 452-60 (1987). There is no way for MTF or voluntary market insurers to charge retroactively higher premiums for earlier policy periods. Thus, the continued inadequacy of MTF rates, if indeed they are inadequate, would constitute a continually increasing loss that could never be made up. In these

circumstances, all practical speed is the only acceptable pace for appropriate proceedings for review and evaluation of MTF rates. It may not be possible to make definitive judgments about MTF's predicted losses, but there are enough problem indications to require the Commissioner's immediate attention. He must determine if losses are and will be sustained at present premium levels. If so, he must determine what increases to direct in order to operate MTF on a breakeven basis. The Commissioner can not responsibly wait for sufficient information to be absolutely sure. If he were operating MTF with public funds, it would be unthinkable for him not to keep a constant eye on the bottom line. He owes no less to the insurance companies.

We have considered denying any present relief, and relegating the insurers to whatever defenses they may later assert if the Commissioner bills them for MTF losses. Since the bills would come so late in the day, the result of relieving insurers of their burden would be serious. The legislation contemplates no alternate source of MTF subsidy. The question whether MTF is something other than a part of the Insurance Department, financed by general tax revenues, would obviously be a focal issue.

We suggest no answers to any of these questions. In particular, we do not say whether the insurers could avoid MTF bills if they could prove that the Commissioner knowingly ran MTF at a loss, or what the alternate source of funds would be. We say only that there are no happy answers to such questions, and that only immediate attention by the Commissioner can lessen their impact.

We also express no opinion on the Advisory Board's suggestion that Allstate could independently and at its own expense apply to the Commissioner for an MTF rate increase. It has not attempted to do so, and we have no occasion to deal with the possibility.

The manner of proceeding to consider and determine MTF rates will forthwith be chosen by the Commissioner. The proceeding must afford interested parties a voice and reasonable advance access to the relevant information in the hands of the Department of Insurance. The Commissioner must act speedily. Proceedings conducted at a leisurely pace can consume many months and confirm the insurers' suspicion that the Commissioner is in no hurry to look realistically at MTF rates. Recognition of the fact of regulatory lag will excuse only delay that is absolutely unavoidable. *Helmsley v. Borough of Fort Lee*, 78 *N.J.* 200, 226-30 (1978), *appeal dismissed*, 440 *U.S.* 978 (1979).

We order the Commissioner to meet with representatives of interested parties[6] within 15 days of this opinion to fix a manner and a time schedule for the accomplishment of the purposes identified in this opinion. We expect him to establish a brief timetable for preparation, a forthcoming response to legitimate demands for relevant Department records, and a procedure suited to the protection of the rights of all interested parties.

---

[6] Policyholders are also interested parties. Perhaps the Public Advocate might represent them. *See N.J.S.A.* 52:27E-18. The authority of the Division of Rate Counsel seems broad enough to include such an undertaking.

APPENDIX 14

STATE OF NEW JERSEY

DEPARTMENT OF INSURANCE

December 4, 1991

CN 325
TRENTON 08625-0325

Honorable Samuel F. Fortunato
Commissioner of Insurance
State of New Jersey
Department of Insurance
20 West State Street
CN 325
Trenton, New Jersey 08625-0325

Dear Commissioner Fortunato:

I am submitting for your review and approval a filing for an interim rate increase for the Market Transition Facility (MTF).

After consulting with the MTF Advisory Committee, it is their recommendation that we file for a 22 percent increase on liability coverages, which will result in an overall increase of 15 percent. The liability increase would be as follows:

Bodily Injury	+ 11.2%
Property Damage	+ 5.4
Personal Injury Protection	+ 70.4
Total	22.0%

The MTF will soon have fiscal year end figures including IBNR. At that time a true rate indication will be developed. The Committee has requested that I file another request for the full rate indication.

Very truly yours,

/s/ R. T. Haskins
R. T. Haskins, CPCU, CLU
Special Deputy Commissioner
Market Transition Facility

cc: Public Advocate

Rate Proposal
New Jersey Market Transition Facility

I. INTRODUCTION

The New Jersey Market Transition Facility retained the services of O'Neil Consulting Services to develop an estimate of the maximum possible range of its overall rate level needs. The results of that analysis are summarized in the attached report.

It should be noted that the analysis was completed in an expedited time frame and, therefore, includes a number of limitations as identified in the report.

The purpose of this memorandum is to propose a +15.0% overall rate level change (or increase in income) effective January 15, 1992.

The distribution of the proposed change is described in the next sections.

II. DISTRIBUTION OF OVERALL RATE LEVEL CHANGE

The proposed +15.0% rate level change would be distributed entirely to the liability coverages and then to individual coverage in proportion to the indicated midpoint

rate level changes. The proposed changes by coverage are shown on the attached Exhibit A.

III. EFFECT OF UNMET DEPOPULATION QUOTAS ON MTF RESULTS

It should be noted that some of the current MTF loss is due to the unmet depopulation quotas. Specifically, the MTF currently insures 294,000 cars more than expected at this point in time. Exhibit B displays the dollar impact on MTF results of this unmet quota, assuming that, (1) all of these risks had the same distribution of clean/surcharged as the MTF overall, (2) there was no loss ratio differential between the clean/surcharged risks, and (3) the written premium and earned premium are distributed in proportion to the number of risks. None of these assumptions is very likely to hold. However, they produce a baseline estimate. Deviations from the assumptions, a larger proportion of clean risks in the depopulation pool versus the total market, and a loss ratio differential, result in reductions in the dollar impact of unmet depopulation quotas. Exhibit B page 2 provides an estimate of the dollar impact for various combinations of assumptions regarding the proportion of clean risks in the depopulation pool and the loss ratio differential between clean and surcharged risks. In sum, these calculations suggest that between $50 and $147 million of the MTF loss is due to unmet depopulation quotas.

Exhibit A

12/03/91 01:27 PM

New Jersey - MTF

Private Passenger Automobile Statewide Rate Review
Summary of indicated and Proposed Rate Level Changes

I. Percentage Effects

Coverage	EP (000)	Proposed Overall Rate Level Change
Bodily Injury and UM	$268,569	11.2%
Property Damage	$137,011	5.4%
PIP	$106,603	70.4%
Liability Subtotal	$512,183	22.0%
Comprehensive	$ 92,312	0.0%
Collision	$145,537	0.0%
Physical Damage Subtotal	$237,849	0.0%
All Coverages	$750,032	15.0%

II. Dollar Effects on Written Premium (000)*

Coverage	WP (000)	Proposed Overall Dollar Effect
Bodily injury and UM	$ 428,690	$ 47,904
Property Damage	$ 222,057	$ 12,022
PIP	$ 200,363	$141,108
Liability Subtotal	$ 851,109	$201,033
Comprehensive	$ 136,734	$ 0
Collision	$ 234,847	$ 0
Physical Damage Subtotal	$ 371,580	$ 0
All Coverages	$1,222,690	$201,033

* Written premium shown is for eleven months. Annual dollar effects would be 9.1% greater. Note also, however, that the effective date of 1/15/92 provides for collection of premium at the new rate for only eight and one half months or 70% of the annualized amount. Therefore, 77.3% of the amount shown would be realized additional income.

Exhibit B
Page 1

12/03/91 01:27 PM

New Jersey – MTF
Private Passenger Automobile Statewide Rate Review
Estimated Effect of Unmet Depopulation Expectations

Number of Undepopulated Risks	294,000
% Share of MTF Liability Written Exposure thru 8/31/91	22.3%

Adjusted Percentage Indications*

		Range of Indicated Rate Level Changes*				
Coverages	EP (000)	LOW POSSIBLE	LOW PROBABLE	MIDPOINT	HIGH PROBABLE	HIGH POSSIBLE
Bodily injury and UM	$208,571	6.3%	15.2%	24.0%	32.8%	41.6%
Property Damage	$106,403	-1.4%	6.1%	11.0%	18.1%	84.8%
PIP	$ 82,758	104.3%	127.0%	151.2%	174.0%	198.0%
Liability Subtotal	$397,761	24.7%	35.9%	47.1%	58.4%	86.8%
Comprehensive	$ 71,669	3.1%	6.7%	10.0%	13.3%	17.4%
Collision	$??3,024	-10.9%	-7.3%	-0.7%	-0.1%	3.5%
Physical Damage Subtotal	$164,713	-6.5%	-1.9%	1.7%	8.0%	8.9%
All Coverages	$582,476	15.1%	23.9%	32.7%	41.8%	50.4%

* Estimates were made only for the low possible, midpoint, and high possible points of the range. The others may be interpolated. These estimates assume: (1) the written premium and earned premium are proportional to the number of risks; (2) the risk would have been removed uniformly from all MTF risk categories; (3) the loss ratio for all the categories is the same.

II. Adjusted Dollar Effects of the Indications on Written Premium*

Coverage	WP (000)	Range of Indicated Dollar Effects (000)** LOW POSSIBLE	MIDPOINT	HIGH POSSIBLE	Difference From Current Estimated Range of Indicated Dollar Effects (000)** LOW POSSIBLE	MIDPOINT	HIGH POSSIBLE
Bodily injury and UM	$352,920	$ 21,074	$ 79,555	$134,806	$ 6,062	$22,071	$ 59,391
Property Damage	$172,440	($ 2,498)	$ 20,041	$ 42,459	($ 693)	$ 5,766	$ 12,223
PIP	$165,602	$162,343	$238,228	$508,107	$48,700	$67,003	$ 00,031
Liability Subtotal	$660,972	$181,009	$332,120	$489,232	$ 2,070	$00,402	$140,738
Comprehensive	$108,188	$ 0,297	$ 10,911	$ 18,526	$ 948	$ 3,100	$ 5,328
Collision	$182,382	($ 18,874)	($ 6,789)	$?,355	($ 6,717)	($?,???)	$ 1,629
Physical Damage Subtotal	$200,509	($ 10,577)	$ 4,153	$ 24,552	($ 4,755)	$ 1,188	$ 7,158
All Coverages	$949,541	$164,432	$339,273	$614,114	$47,331	$97,597	$147,592

** Written premium shown is for eleven months. Annual dollar effects would be 9.1% greater. Note also, however, that the effective date of 1/15/82 provides for collection of premium at the low rate to only eight and one months of 70% of the annualized amount. Therefore, 17.3% of the amount shown would be realized additional income.

Exhibit B
Page 2

12/03/91 01:27 PM

Private Passenger Automobile Statewide Rate Review
Estimated Effect of Unmet Depopulation Expectations
Estimates Based on Varying Assumptions

Assumed % Clean of Depop Risks***	Loss Ratio Range****	Overall Dollar Effect on MTF Indicated Rate Requirements (000)* Loss Ratio Differential Surcharged/Clean**			
		1	1.1	1.25	1.5
64.4%	Low	$ 47,301	$ 47,301	$ 47,301	$ 47,301
	Mid	$ 97,597	$ 97,597	$ 97,597	$ 97,597
	High	$147,892	$147,892	$147,892	$147,892
80.0%	Low	$ 47,301	$ 44,020	$ 39,500	$ 32,878
	Mid	$ 97,597	$ 93,365	$ 87,535	$ 78,994
	High	$147,892	$142,909	$138,045	$125,989
100.0%	Low	$ 47,301	$ 39,613	$ 29,499	$ 14,387
	Mid	$ 97,597	$ 87,939	$ 74,636	$ 56,145
	High	$147,892	$136,621	$120,857	$ 97,907

* MTF dollar requirements would be less to the extent shown had depopulation of the 294,000 risks taken place.

** The loss ratio differential has no effect when the proportion of clean risks in the depopulation pool is the same as for the original pool.

*** The proportion of clean risks in the depopulation pool has no effect when the rate differential is 1.0.

**** Only the low possible, midpoint, and high possible points of the range are shown. Values for the others may be interpolated.

New Jersey Market Transition Facility
Report of Rate Level Indication Analysis

I. INTRODUCTION

O'Neil Consulting Services was retained by the New Jersey Market Transition Facility (MTF) to calculate the maximum possible range of its indicated rate level requirements. This report outlines the data, assumptions and methodologies underlying the requested calculation.

This report was prepared in an expedited time frame. Therefore, some of the procedures employed were modified or adapted from other studies completed for the MTF. These areas are noted as applicable in this report.

This report is organized into the following sections: background, conditions and limitations, results, data, and assumptions and methodologies.

II. BACKGROUND

The MTF was created by Section 88 of the FAIR Act and became operational on October 1, 1990. This operational date was coincident with the date after which the JUA (AFIUA) was prohibited by the FAIR Act from issuing or renewing automobile insurance policies. The MTF is a temporary market mechanism designed to facilitate the transition of "eligible" drivers, as defined in the FAIR Act and attending regulations, from the JUA to coverage in the voluntary market. The MTF has only a two year life span. Under the FAIR Act, the MTF was initially authorized to charge the JUA rates. On January 17, 1990, the MTF filed a request for an overall increase in rates with the Commissioner. On May 10, 1991, the Commissioner

granted an overall 18.6% premium increase to the MTF, effective June 15, 1991.

III. CONDITIONS AND LIMITATIONS

The analysis herein was based on the data and information provided by the MTF. No independent audit or verification of the data/information was completed. To the extent such data/information was either inaccurate or incomplete, the results derived therefrom will also be inaccurate, incomplete, and/or biased. To the extent possible, areas of such deficiency were identified and discussed.

Further, this analysis projects loss and expense costs into a prospective rating period. All such projections are estimates and may err due to various unforeseeable contingent events. These include, for example, additional law changes, changes in regulation, or changes in policy7 claim handling procedures.

The ranges of indications included herein were completed at the request of the MTF. OCS makes no representation that the maximum possible range of indicated rate level need discussed herein is appropriate. The limitations of these estimates are discussed further in the results section below.

Finally, as noted above, this report was prepared on an expedited basis. Accordingly, the methodologies used contained assumptions and limitations which might be more explicitly considered in a more detailed study. Specifics of these limitations are discussed in the applicable

sections of this report. These are listed here for reference, as well, without explanation.

1. All calculations were completed as if the MFT were an on-going operation. Trend periods, etc. are fully included for both income and outgo.

2. No adjustment was made to provide for the incomplete policy term available for collection of the required rate.

3. All calculations are prospective. No consideration was given to recoupment for possible past losses.

4. Investment income was estimated in a standard manner. No consideration was given to the fact that funds may not be available for investment if they must be used to pay for prior period losses.

5. No attempt was made to quantify or evaluate potential changes in the size or mix of the MTF book of business.

6. No attempt was made to adjust the data for distortions due to start-up of the MTF such as the lag in earned premium or paid loss.

7. On-level premium was calculated at full value based on the +18.6 rate change, despite the fact that that amount was not realized by the MTF.

8. The one time start-up costs of $5.6 million and other minor miscellaneous expenses were not explicitly included in the calculation.

9. IBNR was estimated without a detailed study.

IV. RESULTS

There were numerous variables underlying the analysis of the MTF rate level level need. Most of these variables lie within a range of the correct result. In this case, the most significant unknown factor was the quantification of the MTF IBNR. Therefore, as requested by the MTF, the range of results was determined thru variations in the selected IBNR factor. OCS calculated the probable range of MTF rate level requirements at +24% to +42%. At the request of the MTF, a maximum possible range was also calculated. This resulted in a maximum possible range of overall indicated rate level need from +15% to 50%. The midpoint of both ranges was +32.7%. The credibility of these results is greatest at the midpoint and decreases as the range diverges in either direction to the point of *essentially zero credibility at the endpoints* of +15% and +50%.

Therefore, although the maximum possible range is from 15% to 50%, it is OCS's opinion that the *maximum probable range is from 24% to 42% with the most probable result at 32.7%. The results of the maximum possible range should be viewed with extreme caution. Implementation of a rate change less than the probable range would be, based on the information currently available, actuarially unsound and likely result in an MTF deficit.*

Results by coverage are shown on Exhibit 1.

The effective date underlying the indicated rate level changes is 1/15/92.

V. DATA

The underlying data were taken primarily from monthly summaries of operations provided to the MTF by AIPSO. The data are by policy year and accident year from inception of the MTF, October 1, 1990, thru August 31, 1991, a period of eleven months. Data elements provided were extensive and included, income items: written premium, earned premium, written DIP/DRDP, earned DIP/DRDP, and outgo items: paid loss, outstanding loss, UCJF recoveries, paid ale, directly reimbursable expenses, SIU expenses, claim service fees, non-claim service fees, and commissions written.

Data were also obtained from a variety of other sources. Administrative costs, premium taxes, and the expected UCJF assessment were estimated from the MTF Financial Statements.

VI. ASSUMPTIONS AND METHODOLOGY

The assumptions and methodology associated with each step of the calculation are described below.

A. Income Items.

1. Written Premium

DIP/DRDP written premium was available only for liability as a whole. For purposes of determining the required rate level by coverage, DIP/DRDP written premium was apportioned to each liability coverage based on the proportion of each coverage's written premium to total liability written premium.

2. Earned Premium

Earned premium by coverage was estimated because neither earned nor unearned premium were available by coverage for the non-quarter ending month of the experience period (August). The estimate was completed by allocating the total liability unearned premium at August to coverage based on the known proportion at June. The same procedure was applied to the physical damage coverages.

Unearned premium was allocated to DIP/DRDP in a similar manner. The resulting DIP/DRDP earned premium was then allocated to coverage in proportion to earned premium.

3. Earned Premium at Current Rates/Premium Trend

Effective June 15, 1991, the MTF was granted an 18.6% premium increase in the form of the DRDP rating factors and increased flat dollar accident surcharges. The factors utilized by the DRDP apply to all coverages except PIP while the flat dollar accident surcharges relate to all coverages. Accordingly, the effect of the 18.6% rate level change was apportioned to DRDP and the effect of the increased accident surcharges. This computation resulted in premium effects of 20.8% for all coverages except PIP and 8.3% for PIP. An on-level adjustment factor was developed using the parallelogram method and applied to all coverages. The on-level factors were 1.202 for all coverages except PIP and 1.081 for PIP.

It should be noted that the +18.6% premium change resulted from changes in rates only for risks with one or

more points. The estimated value of the premium change was based on the assumption that 59% of MTF insureds would have one or more points. The actual figure has been about 36%. Therefore, the value of the last MTF rate level change was overstated. Nonetheless, the full value was included herein.

Physical damage coverages were also adjusted to provide for model year rating and symbol drift. Due to time constraints, the factors developed in the Mercer draft report of July 12, 1991 were used. These were, 14.1% for comprehensive and 9.9% for collision.

Due to start-up of the MTF operation, earned premium is probably somewhat understated relative to a going concern operation. No attempt was made to adjust for this observation.

The understatement in earned premium due to start-up offsets against the overstatement resulting from the on-level factor estimate. No attempt was made to quantify the extent of this offset.

4. Investment Income

Investment income was incorporated into the permissible loss ratio by applying a cash flow approach to the other income/expense items. This method and its various parameters is described in a later section. The interest rate used for discounting was 5%, about the level of current MTF earnings.

It would be noted that no consideration was given to the fact that funds anticipated in this model may not be

available for investment if they must be used to pay prior period losses.

5. Premium Installment Fees

The total amount of such fees thru August was not available for this report. The amount thru July was just under $9 million. Therefore, the estimated eleven month amount was $10 million. This amount was included as an add-on to the otherwise calculated on-level earned premium. It was distributed to coverage in proportion to written premium.

B. Losses

1. Paid Loss, Outstanding Loss, IBNR

Paid loss was taken from the AIPSO reports for the first eleven months of the MTF operation. PIP was net of UCJF recoveries and comprehensive and collision were net of salvage and subrogation.

Brief review of these data suggest that the BI paid loss is experiencing a payout lag which exceeds the start-up lag of the AFIUA based on the observed level of paid loss to date. A similar lag was also observed for outstanding loss.

Because there was insufficient time to complete a full study of the required MTF IBNR, a factor was developed to reasonably approximate this value. First, the eleven months of actual MTF data were developed to 12 months using the observed month-to-month outstanding and cumulative paid history of the MTF. These data are shown on Exhibit 6.

Then development factors from 12 months to ultimate were derived using the AFIUA incurred loss development data for accident year 1984 as provided in the Milliman & Robertson 12/21/90 AFIUA reserve study. The AFIUA 1984 data were used in an attempt to recognize the start-up lag. The 11-12 month and 12 month to ultimate factors were combined to yield indicated IBNR factors by coverage.

Given the uncertainties associated with setting IBNR reserves generally, and the additional uncertainties in the New Jersey market, a range of development factors to ultimate was selected. The selected range for BI was adjusted upward in an attempt to somewhat adjust for the perceived understatement in observed payouts to date. Therefore, the low end of the range exceeds the indicated factor. The selected range around the midpoint was plus or minus 16.7%. PIP was viewed as similarly variable with a range of plus or minus 21%. The selected ranges for the remaining coverages were narrower, given their lesser expected variability. As for the rate level indications in total, the midpoint is the most credible estimate, with credibility decreasing as the figures diverge from the midpoint to essentially zero at the endpoints. The maximum probable range arises from selection of loss development factors midway between the low possible and midpoint, and high possible and midpoint.

The final selected factors are displayed on Exhibit 6.

2. Loss Trend

Because there have been numerous law changes over the last several years, trend data are sparse to non-existent.

Therefore, a combination of data sources and judgment was relied on in selecting trend amounts. These included Fast Track thru June for New Jersey, New York (BI only), and Countrywide, various CPI cost indices, and internal ISO trend data for PD. The selected amounts are described by coverage below.

a. Property Damage

For property damage severities, New Jersey Fast Track data were relied on with reference to various CPI indices which relate to automobile repair labor and parts costs. Indices related to labor were around 3% while indices related to parts costs were declining slightly.

New Jersey Fast Track data thru 6/91 has shown declining trends for both frequency and severity. The severity trend indications were +9.3, +6.2, +3.5, and +0.8, for the last 19, 12, 9, and 6 quarters, respectively. Given these trend indications and the CPI indices, a conservative severity trend of 7% was selected.

For frequency, the Fast Track data also indicated continuing declining trends. The indications were -4.5, -6.1, -7.2, and -8.5, respectively for the last 19, 12, 9, and 6 quarters. Therefore, a very conservative trend of -5.0% was selected.

It should be noted that the declining frequencies and severities observed in the New Jersey Fast Track data are corroborated by similar movement in the countrywide Fast Track indications. These are displayed on Exhibit 4 for reference.

These selections produce a pure premium trend of 1.7%.

ISO furnished the MTF with trend data thru June, 1991 for voluntary and residual market business combined and for residual market business alone. These data have two basic inherent difficulties as follows: (1) ISO did not collect data for the AFIUA (residual market) for all carriers until second quarter 1989, (2) one of the servicing carriers (CSC) has not reported claim count information to ISO. The first difficulty distorts trend indications based on more than 5 points (from June, 1990 to June, 1991). The second difficulty was eliminated by ISO's estimate of CSC claim counts. No independent review of these estimates was made.

The five point exponential pure premium indications based on the ISO data were +1.0% for total market data, and +0.2% for residual market data. These indications are consistent with the Fast Track indications and CPI indications discussed above, as well as with the selected +1.7% pure premium trend.

A summary of the indicated and selected frequency and severity trends is shown on Exhibit 4 pages 1 and 2.

b. Bodily Injury

Because of the changes in the no-fault threshold over the last seven years, New Jersey BI trend data are not meaningful as a reference in selecting trends. Further, separate frequency and severity trends are required in order to accurately reflect the anticipated environment.

Severity trends were selected with reference to the various CPI Medical Care Cost data and actual cost experience in New York. The CPI data indicate that costs are

increasing at about 7% per year for services (specifically, 5.4% for Physician's Services and 8.6% for the Medical Care Cost Index) and at about 9% to 10% for hospital costs (specifically, 9.5% and 10.8% for Hospital Rooms and Outpatient Hospital, respectively). The actual cost experience in New York, with the same verbal threshold as New Jersey has been declining and is currently around 2% to 4%. Based on the available data and judgment a 10% severity trend amount was selected.

For BI frequency, there were no valid New Jersey data because of the many changes in the threshold. Therefore, although there is not necessarily a one-to-one correlation between accident frequency and injury frequency, property damage frequencies were reviewed as a surrogate for the missing data. These data show continuing drops in accident frequency as discussed above. Based on these data, a -2.5% frequency trend was selected for BI (one-half of the selected PD frequency). Note that there may be continuing shifts in the distribution of business over time toward the verbal threshold which will tend to exert further downward pressure on frequencies (and upward pressure on severities). Note also that this selection is consistent with the frequency changes observed in New York at this point in time following introduction of the verbal threshold (about four years subsequent).

A summary of the indicated and selected frequency and severity trends is shown on Exhibit 4. The selected values result in a pure premium trend of 7.3%.

Given the number and kinds of law changes that have taken place over the last several years, the ISO trend data were not useful as support for the selected BI trend.

c. Personal Injury Protection

For severity, the data relied on included the same CPI sources as referenced for BI and the New Jersey Fast Track data. In referencing the Fast Track data, it was noted that it contains distortions due to the changes in PIP coverage over the last several years such as introduction of deductibles and a co-payment. Therefore, the CPI data were given the most consideration and a conservative 10% severity trend was selected. This was then reduced by 1% to 9% in recognition of the introduction of the medical fee schedule.

The selected frequency trend of -1% was based on the observed change in the Fast Track frequency from 1987 to 1988 (the last data available prior to the 1989 law changes) of -1.9%.

A summary of the indicated and selected frequency and severity trends is shown on Exhibit 4. The selected values produce a pure premium trend of 7.9%.

Given the number and kinds of law changes that have taken place over the last several years, the ISO trend data were not useful as support for the selected PIP trend.

d. Comprehensive

Indicated trends based on New Jersey Fast Track data suffer from distortion due to shifts in distribution of business by deductible. However, current values show declining trends similar to those observed for PD. Although not directly comparable, a similar downward pattern appears in the countrywide Fast Track data.

Given that no valid data for this coverage were available, a 6% change in pure premium was judgmentally selected. This is consistent with the last available ISO trend calculated excluding wind and water losses at 8% and the currently observed CPI changes for vehicle repair costs at an average of 1.2%.

e. Collision

Because these data were also distorted due to shifts in distribution of business to higher deductibles, the same CPI sources referenced for PD were used here to select the pure premium trend of 1.7%, the same as the PD pure premium trend. A summary of the indicated and selected frequency and severity trends is shown on Exhibit 4.

f. Trend Period and Method of Application

The selected frequencies and severities were trended exponentially. The trend period was from the average date of loss in the historical experience period to the average date of loss in the ensuing experience period.

C. Expenses

1. Claim Service Fees Paid

Claim service related costs include the servicing carrier fees, directly reimbursable expenses, SIU allowance, and ale paid with MTF funds. Servicing carrier fees were treated as unallocated loss adjustment expenses (ule) and subjected to the expense trend procedure. The remaining expenses were treated as ale and included with losses.

The fixed monthly fee paid to Computer Sciences Corporation was allocated to coverage in proportion to the other expenses by coverage.

2. Non-Claim Service Fees and Other Expenses

Non-claim service fees were allocated to coverage in proportion to written premium by coverage. A 1% loading, based on observed actual costs to date, was included to cover MTF administrative costs.

3. Expense Trend

MTF costs consist primarily of fees paid to the servicing carriers for policy and claims processing. These fees are based on numbers of policies and numbers of claims. Thus, the prospective expense amounts would appropriately be derived based on projection of these underlying elements. The servicing carrier contracts also provide for CPI adjustments to the per unit costs. Due to time constraints a method of trending expenses was applied in lieu of projecting the underlying parameters. This method consists of developing a current cost factor utilizing the latest CPI indices and trending from that point to the appropriate date in the prospective experience period. For non-claim expenses this is six months beyond the expected effective date of the new rates and for claim expenses it is the expected date of loss in the prospective rating period.

The resultant current cost factor and expense trend values were 1.013 and +3.5%, respectively.

4. Other Expenses

Other expenses include commissions, premium tax, UCJF assessment, start-up costs, administrative costs of operation, and various miscellaneous expenses. The following assumptions were made regarding each expense item.

a. Commissions

These were set at the ratio of actual commissions written to premiums written as provided on the AIPSO reports. This resulted in the unexpected amounts of 8.2% for liability and 9.3% for physical damage.

b. Premium Tax

This was derived from the figures included in the MTF financial statements at 0.25%.

c. UCJF

The MTF has set aside provision for a 7.3% UCJF assessment.

d. Start-Up Costs

MTF servicing carriers were reimbursed for start-up costs in the amount of $5.6 million. Because this was a one time cost, it was not included in the calculated required rate level indication. However, it is an amount which the MTF must fund in its rates at some point.

e. Administrative Costs

According to its financial statement, the MTF has current operating costs of about 0.7%. This was increased to 1% based on information from MTF management.

f. Miscellaneous Expenses

The MTF financial statement displayed various miscellaneous expenses which are not all captured within the MTF administrative allowance. These include items such as premiums charged off. There are also offsetting items such as commissions charged off. For expediency these items were not explicitly relected in these calculations. Their effect on the overall result would be minimal.

D. Cash Flow Analysis

The various income and outgo items were included at the values cited above. The timing of each item is described below. As noted earlier, a 5% discount factor was applied.

1. Premium Collection

The quarterly payout pattern of 58%, 14%, 28%, and 28% was based on the MTF six pay plan.

2. Loss and ALE

Absent an IBNR study, the quarterly payout pattern was taken from the Mercer July 12, 1991 draft financial report. These patterns reflect expected closure of all claims within a seven year period. These time frames appear to be too short for the liability coverages. However, no

adjustment was made. Nor were these patterns adjusted for the different IBNR estimates.

[Exhibits Omitted]

APPENDIX 15

SUBCHAPTER 29. ORDERLY WITHDRAWAL OF INSURANCE BUSINESS

11:2-29.1 Purpose and scope

(a) The purpose of this subchapter is to establish the requirements and procedures by which insurers may undertake an orderly withdrawal from the business of insurance in this State, thereby minimizing the adverse effects upon policyholders of eliminating coverage; preventing or minimizing the disruption in the marketplace and harm to the public that would otherwise occur in the absence of regulation; and permitting insurers to wind down their business in an orderly fashion as is consistent with N.J.S.A. 17:17-10 and 17:33B-30.

(b) This subchapter applies to all insurers that seek to withdraw from the business of insurance as defined herein.

11:2-29.2 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

"Affiliate" means an insurer that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the insurer that initiates a withdrawal, as defined in N.J.S.A. 17:27A-1.

"Annual statement" means the form of statement that is described in N.J.S.A. 17:23-1.

"Applicant" means the insurer seeking approval to withdraw from the business of insurance in this State.

"Assumption agreement" means a contract between insurers whereby one insurer transfers all or substantially all its rights, duties and obligations arising from certain policies to another insurer.

"Authority" means the power granted by the Commissioner which enables an insurer to transact the business of insurance.

"Automobile" and "automobile insurance" are as defined in N.J.S.A. 17:30E-3.

"Business of insurance" or "insurance" means any kind, line, subline, or a portion thereof authorized by Chapters 17 or 32 of Title 17 of the Revised Statutes.

"Commencement date" of withdrawal means the date which the applicant may begin withdrawing from this State pursuant to the approved plan of orderly withdrawal.

"Commissioner" means the Commissioner of the New Jersey Department of Insurance.

"Control" is as defined in N.J.S.A. 17:27A-1.

"Department" means the New Jersey Department of Insurance.

"Effective date" of withdrawal means the date at which the applicant has complied with any and all conditions contained in the approved plan of orderly withdrawal.

"Insurance holding company system" consists of two or more affiliated persons, one or more of which is an insurer as defined in N.J.S.A. 17:27A-1.

"Insurance producer" or "producer" means any person engaged in the business of an insurance agent, broker or consultant, as those terms are defined in N.J.S.A. 17:22A-2.

"Insurer" means an insurer or eligible surplus lines insurer, and any insurance affiliates thereof, authorized or admitted pursuant to Chapters 17 or 32 of Title 17 of the Revised Statutes to transact in this State the business of insurance as defined herein.

"Plan" means a plan of orderly withdrawal from insurance business in New Jersey.

"Multi-state account" means a single contract or policy of commercial lines insurance as defined in N.J.S.A. 17:29AA-3 which covers risks or locations in both New Jersey and at least one other state; any group policy in which covered members of the group reside in New Jersey and at least one other state; and any plan approved for the mass marketing of insurance pursuant to N.J.A.C. 11:2-12 in which policyholders of the plan reside in New Jersey and at least one other state.

"Portfolio reinsurance agreement" means a contract between insurers whereby one insurer transfers its entire liability for in-force policies or outstanding losses, or both, to another insurer regarding a described segment of insurance business.

"Rating system" means every schedule, class, classification, rule, guide, standard, manual, table or rating plan by whatever name described containing the rates, rules and forms used by any insurer or by any rating organization in determining or ascertaining a rate.

"Reinsurance agreement" means a contract between insurers whereby one insurer agrees to insure part or all of an insurance risk of an originating, or ceding, insurer.

"Residual market mechanism" means any program authorized or created by the New Jersey State Legislature which is designed to provide an insurance market for insureds who are unable to obtain insurance in the voluntary market.

"State" means the State of New Jersey.

"Withdraw" or "withdrawal" means the nonrenewal, cancellation, or termination of policies, or surrender of authority to transact the business of insurance in this State, or any insurer action that is equivalent to a withdrawal from the business of insurance in this State which may include, but is not limited to, the elimination of a rating system, termination of agency contracts, reduction in agency commissions, restrictions on agency solicitation or binding authority, insurer refusal of applications or declaration of a dividend to an affiliate, when such action or actions exceed those occurring in the ordinary course of business. Whether the above activities are equivalent to a withdrawal shall be determined by the Commissioner on a case-by-case basis.

. . .

"Withdraw" or "withdrawal" also means the transfer to another insurer of insurance business pursuant to an assumption agreement as defined herein or a portfolio reinsurance agreement as defined herein.

11:2-29.3 General provisions

(a) Any insurer that seeks to undertake any of the actions described as withdrawals in N.J.A.C. 11:2-29.2 shall provide the Commissioner with written notification so that he or she may determine whether the insurer must file a plan of orderly withdrawal pursuant to N.J.A.C. 11:2-29.4 or, if such plan is waived by the Commissioner under circumstances he or she considers appropriate, a reasonable substitute withdrawal procedure approved by the Commissioner.

(b) Any insurer that is required by the Commissioner to file a plan of orderly withdrawal pursuant to N.J.A.C. 11:2-29.4 shall submit to the Department an original and five copies of a proposed plan for prior approval thereof.

1. The Commissioner shall not begin his or her evaluation of the proposed plan until the applicant has complied with the requirements contained herein for its submission. Including the submission of any additional information specifically required pursuant to N.J.A.C. 11:2-29.4(b), after which the Commissioner shall approve the plan within 120 days, subject to the terms and conditions which he or she may consider appropriate.

i. The Commissioner shall acknowledge to the applicant the receipt of any filing and request any additional information required for review pursuant to N.J.A.C. 11:2-29.4(b) within 30 days thereafter, the failure of which shall allow the applicant to treat the filing as complete.

ii. The Commissioner may extend the 120 day time frame for approval of the plan an additional 40 days for good cause and shall provide notice to the applicant of such extension.

2. An applicant shall not commence any action in furtherance of a withdrawal as defined herein prior to the Commissioner's approval thereof. For the purposes of this paragraph, commencing an action in furtherance of a withdrawal does not include the non-binding oral or written communication between an insurer/applicant and another insurer in negotiating a replacement of the insurer/applicant's insurance business by the other insurer, the negotiation of an agreement with a replacement carrier subject to approval of the Commissioner and conditioned on approval of the plan, or non-binding oral or written communications with any of the entities set forth at N.J.A.C. 11:2-29.4(a)11.

3. The authority of an applicant to conduct the business of insurance from which it seeks to withdraw, as well as any other authority which it is required to surrender pursuant to this subchapter shall, upon approval of the plan, continue in effect, but only in accordance with the plan as approved.

4. No withdrawal shall become effective until the applicant has complied with any and all conditions contained in the approved plan which relate to the effective date of withdrawal.

5. Unless the applicant specifically requests and is granted a waiver, the applicant shall make either or both of the following special deposits, as a condition of approval of the plan, in securities or the equivalent thereof in performance bonds as determined by the Commissioner, until such time as the applicant's liabilities as determined by the Commissioner no longer exist in this State:

i. A deposit established with and in the name of the Commissioner for the benefit of all of the applicant's New Jersey policyholders, claimants and creditors which shall be equal to an amount not to exceed 125 percent of the applicant's current and potential liabilities existing or that may exist in this State;

ii. A. deposit established with and in the name of the Commissioner pursuant to a consent order signed by the applicant to guarantee compliance with the approved plan, a material breach of which may, upon notice to the insurer, result in an immediate forfeiture of the deposit in whole or in part. This deposit shall be in an amount established at the discretion of the Commissioner and may equal the greater of one million dollars or 10 percent of the applicant's average annual net direct premiums written within the last three years in the line(s) from which it seeks to withdraw.

6. The applicant may substitute, with the approval of the Commissioner, in place of the deposits required in (b)5i above, the following:

i. A proper guarantee from its immediate or ultimate parent;

ii. A letter of credit;

iii. A trust agreement; or

iv. Any other financial guarantee of the applicant's total liabilities.

7. For good cause shown, the Commissioner may waive the special deposits or substitutes required in (b)5 and 6 above upon a consideration of factors including, but not limited to, the uniqueness of the applicant's circumstances, its size, and its volume of business and whether the withdrawal is being effected pursuant to an assumption or portfolio reinsurance agreement.

(c) The Commissioner may require as a condition of approval of the plan the surrender of some or all certificates of authority, issued pursuant to Chapters 17 or 32 of Title 17 of the Revised Statutes, held by the applicant or by other companies within the same insurance holding company system as the applicant for amendment, termination, suspension, restriction or such other modification as the Commissioner considers appropriate. Upon specific request by the applicant for a waiver of any portion of these requirements the Commissioner may grant the waiver in whole or in part if the Commissioner finds that, based upon proofs presented, one or more of the following mitigating circumstances exist:

1. The withdrawal will not cause a market availability problem or an undue disruption in the marketplace;

2. The applicant will enter into an agreement with a proposed replacement carrier to assume the applicant's existing book of business conditioned, however, upon an approved plan;

3. The withdrawal will not adversely affect competition;

4. The withdrawal is due to specified problems affecting the solvency of the applicant;

5. The withdrawal is consistent with the insurer's overall plan of withdrawal in other jurisdictions as part of a corporate restructuring; or

6. The public interest is best served by such a waiver.

(d) If more than one insurer within the same holding company system seeks or is required by the Commissioner pursuant to this subchapter to withdraw from the business of insurance in this State, each withdrawing affiliate shall submit a separate plan to the Commissioner pursuant to this subchapter or, if such plan is waived pursuant to (a) above, a reasonable substitute withdrawal procedure approved by the Commissioner.

(e) An insurer that currently services a residual market mechanism and is subject to the withdrawal provisions contained in the plan of operation governing such mechanism is exempted from the requirements of this subchapter to the extent of the insurance business serviced by the insurer in such mechanism.

(f) The applicant and its affiliates shall be prohibited for a period of up to five years after the effective date of withdrawal from acquiring, directly or indirectly, a controlling interest in any insurer that is licensed to do business in this State without approval of the Commissioner.

11:2-29.4 Elements of proposed plan of orderly withdrawal

(a) A proposed plan of orderly withdrawal shall contain the following information supported by adequate proof of the validity thereof, if not specifically required herein:

1. The reasons the applicant seeks to withdraw, supported by a description and documentation of the applicant's financial condition for the last three years or such other period as the Commissioner considers appropriate, including the underlying accounting, actuarial and other relevant data or material relied upon in deciding to seek withdrawal;

2. The proposed commencement date of such withdrawal;

3. A description of the following:

i. All authority currently and previously held by the applicant in all jurisdictions (specifically listing states in which the applicant has withdrawn);

ii. The authority in New Jersey currently and previously held by its insurer affiliates, including dates of issuance, surrender, suspension or revocation; and

iii. The authority in other jurisdictions held by the applicant or its insurer affiliates that has recently been surrendered or is intended for surrender currently and in the future;

4. An organizational chart and narrative description of the relationships among the applicant and its insurer affiliates, if any, indicating at a minimum:

i. The business of insurance which each has authority to write in New Jersey;

ii. The management relationships;

iii. The financial relationships (for example, reinsurance agreements, pooling arrangements, common investments, etc.);

iv. The marketing relationships;

v. The agency relationships;

vi. The claims handling relationships; and

vii. Whether any of the applicant's insurer affiliates are also taking action or applying to withdraw from the business of insurance in this State (and if so, the details thereof);

5. A description, by line of insurance written in New Jersey, of the applicant's and its insurer affiliates' business (both property/casualty and life/health) during the last three years, including for each year the corresponding premium volume, number of current policyholders, number of exposures, approximate market share and the number of insurance producers and employees servicing the business. If employees of the

applicant or any of its affiliates will be terminated in this State as a result of the applicant's withdrawal, a description of the method of termination, a description of the termination benefits, and any other financial or nonfinancial accommodations made on the employees' behalf shall be included;

6. The address of each of the applicant's offices in this State;

7. Copies of the proposed cancellation and nonrenewal notices, and termination notices, the applicant intends to send to its policyholders and insurance producers, respectively, as well as any other withdrawal-related correspondence, including the proposed dates of such notices or correspondence. Producer termination notices shall comply with the requirements contained in N.J.S.A. 17:22-6.14a;

8. In the case of a proposed withdrawal of life, health or annuity business to be effected through one or more assumption agreements, the proposed certificate(s) of assumption and letters of notification (where appropriate) to policyholders informing them of the transfer of their policies to another insurer. In the case of a proposed withdrawal of other than life, health or annuity business to be effected through one or more portfolio reinsurance agreements, the reinsurance agreement(s) and letters of notification (where appropriate) to policyholders informing them of the reinsurance of their risks with another insurer;

9. The name and address of each insurance producer, as well as the number of policies sold and premium volume produced by each producer, by line of

insurance, for a 12 month period prior to the filing of the proposed plan;

10. A specimen copy of each current producer contract;

11. Copies of all correspondence and notices to be sent to the following entities or their statutory successors, as well as a description of all agreements (which need not be in final form) reached with such entities or their statutory successors as to the applicant's financial and reporting obligations to them, as applicable; if not applicable, an explanation why. The following list is not intended to be exhaustive. It is the responsibility of the applicant to furnish the information required under this paragraph for any other statutorily created or authorized entity to which it owes or may owe a financial or reporting obligation. The Commissioner may require the applicant to deposit with any of the below-listed entities (or their statutory successors) an amount sufficient to meet the applicant's obligations thereto.

i. The Unsatisfied Claim and Judgment Fund established pursuant to N.J.S.A. 39:6-61 et seq.;

ii. The New Jersey Property-Liability Insurance Guaranty Association established pursuant to N.J.S.A. 17:30A-1 et seq.;

iii. The New Jersey Automobile Insurance Risk Exchange established pursuant to N.J.S.A. 39:6A-21 through 22.1;

iv. The Mutual Workers Compensation Security Fund established pursuant to N.J.S.A. 34:15-112;

v. The Stock Workers Compensation Security Fund established pursuant to N.J.S.A. 34:15-105;

vi. The New Jersey Insurance Division of Fraud Prevention established pursuant to N.J.S.A. 17:33A-1 et seq.;

vii. The Commercial Automobile Insurance Procedure established pursuant to N.J.S.A. 17:29D-1;

viii. The New Jersey State Division of Taxation for premium taxes required by N.J.S.A. 54:18A-1 et seq. and 17:33B-49;

ix. The Surplus Lines Guaranty Association established pursuant to N.J.S.A. 17:22-6.70 et seq.;

x. The Medical Malpractice Reinsurance Association established pursuant to N.J.S.A. 17:30D-1 et seq.;

xi. The Market Transition Facility established pursuant to N.J.S.A. 17:33B-11;

xii. The New Jersey Automobile Full Insurance Underwriting Association for examination assessments provided by N.J.S.A. 17:30E-18.1;

xiii. The New Jersey Automobile Full Insurance Underwriting Association for residual market equalization charges and policy constants established pursuant to N.J.S.A. 17:30E-8 and 17:29A-37.1, respectively; and

xiv. The Department of Insurance for examination fees provided for by N.J.S.A. 17:23-1 et seq. and other statutory fees provided for by N.J.S.A. 17:33-1;

12. A statement, by line of insurance written in this State, of all of the applicant's current incurred liabilities

and reserves, including those incurred but not reported, as developed and certified by a "qualified actuary" as defined in N.J.A.C. 11:1-21.1 for property and casualty lines and by a Fellow of the Society of Actuaries for life and health lines, as of a date not earlier than 90 days prior to the submission of the proposed plan and which shall include the following in the case of insurance other than life:

i. Copies of all work papers of the actuary supporting the actuarial opinions;

ii. Copies of all underlying statistics used by the actuary;

iii. If not included in (b)12ii above, development triangles, New Jersey only and countrywide for the following. Triangles shall be constructed as of December 31 for as many accident years and as many development years as necessary to display at least five mature accident years. For the purpose of this requirement, a mature accident year is defined as one for which paid losses equal at least 99 percent of incurred losses including IBNR. Such data shall be supplied both in hard copy and as their ASCII equivalent. Any narrative necessary for proper interpretation of the data supplied shall be provided.

(1) Paid losses;

(2) Incurred losses; and

(3) Claim counts;

(A) Reported; and

(B) Closed; and

iv. If the insurer does not have five mature accident years as required in (b)12iii above, then it shall display five accident years which are the closest to being mature, and if the insurer does not have five accident years of data, then it shall display the accident years it has.

13. A description of the manner in which the applicant has in the past three years handled and intends to handle claims, premium factor charges, premium billing, and policyholder service regarding policies held by New Jersey residents remaining in force after the plan has been approved. Provide a description of the applicant's staff and adjusters servicing these claims, including the servicing location and the procedures for consumer contact;

14. A list of all the applicant's and its affiliates' deposits, if any, currently held pursuant to N.J.S.A. 17:20-1 et seq.;

15. A description of the kind and amount of all reinsurance assumed and ceded by the applicant identifying each ceding and assuming insurer and describing the corresponding risks in each reinsurance agreement. An explanation of whether the proposed withdrawal will affect the surplus of another insurer as a result of the loss of credit received by that insurer on any of the applicant's assumed reinsurance, as well as a description of the procedures designed to minimize any marketplace disruption or hazardous financial condition that may occur as a result of the loss of credit, shall be included;

16. A description of all multi-state accounts under which insurance has been provided for risks located in

New Jersey, as well as an explanation of the impact of withdrawal on such risks;

17. The proposed amount of the special deposits required under N.J.A.C. 11:2-29.3 (b)5, which shall be maintained until such time as the applicant's liabilities and potential liabilities no longer exist in this State;

18. Written certification from a duly authorized officer of the applicant, signed under the pains and penalties of perjury, that the information submitted in the proposed plan is accurate and complete to the best of his or her belief and that for as long as insurance policies are in force or there are unpaid losses or expenses in this State:

i. The applicant shall fully honor all of its legal obligations in this State;

ii. The applicant shall continue to service, without discrimination, all outstanding policies, bonds and surety obligations, which includes processing all usual and customary endorsements requested by insureds during the term of such policies, subject to the applicant's normal underwriting standards;

iii. The applicant shall continue to submit annual statements and information required by the entities set forth in (a)11 above, upon request, for as long as the applicant has any unearned premium or any unpaid or incurred losses in this State;

iv. The applicant shall continue to operate in accordance with the laws and regulations of this State and remain subject to examination by the Department for as long as considered necessary by the Commissioner;

v. The applicant shall not accept any new business whatsoever in this State unless authorized or required by the Commissioner, including reinsurance and excess or surplus lines placements; and

vi. The applicant shall maintain its designation of the Commissioner as its agent for service of process; and

19. The plan shall include a method acceptable to the Commissioner to verify the applicant's compliance with its obligations under the plan as approved which may include, but is not limited to, quarterly financial and informational reports of the applicant's progress under the plan.

(b) The Commissioner may require any other information he or she considers relevant to the evaluation of the request to withdraw.

11:2-29.5 Replacement; non-renewal

(a) Notwithstanding the provisions of N.J.A.C. 11:3-8.3, if an applicant's request to withdraw involves private passenger automobile insurance and the applicant is required to submit a proposed plan, the applicant is subject to the following additional conditions which must be addressed in the proposed plan;

1. The applicant shall seek to place its business with a voluntary market replacement carrier or carriers acceptable to the Commissioner for a specified period of years after the Commissioner's approval of the plan or until all automobile insurance is replaced, whichever is sooner.

i. The period of time in which an applicant must seek to place its business with a replacement carrier will

be determined by the Commissioner, but in no instance will it be less than one year or more than five years. If, at the end of the designated period, the applicant has not succeeded in placing all of its private passenger automobile insurance policies with a vountary [sic] market carrier, the applicant shall begin an orderly process of nonrenewal at a rate designated by the Commissioner. In accordance with such process, the applicant shall provide two notices of nonrenewal to remaining policyholders. Unless the Commissioner finds that good cause exists for shortening the initial notice period, the first nonrenewal notice shall be provided at least one year prior to the next policy expiration date and its contents shall comply with the provisions of N.J.A.C. 11:3-8.3. The insurer shall issue a second notice of nonrenewal in compliance with the time and content requirements of N.J.A.C. 11:3-8.3.

ii. An insurer which acts as a replacement carrier for the private passenger automobile insurance business from which the applicant seeks to withdraw assumes all of the legal rights, duties and obligations associated with the participation of private passenger automobile insurers in the automobile insurance market in this State.

2. An applicant shall be required to accept the quotas established by N.J.S.A. 17:33B-11(c)5 unless the applicant specifically requests and the Commissioner agrees to a waiver of this requirement.

(b) If an applicant's request to withdraw involves other than private passenger automobile insurance, the applicant may be subject to conditions addressed either in the approved plan or, if the plan is waived pursuant to

N.J.A.C. 11:2-29.3(a), in a reasonable substitute withdrawal procedure approved by the Commissioner.

11:2-29.6 Confidentiality of plan of orderly withdrawal

(a) All data or information contained in the plan is confidential and will not be disclosed by the Department to any person other than its employees and representatives, except the following items, but only upon written, specified request and upon notice to the insurer/applicant:

1. N.J.A.C. 11:2-29.4(a)3i – Description of current and prior authority to do business by jurisdiction;

2. N.J.A.C. 11:2-29.4(a)4 – Organizational chart;

3. N.J.A.C. 11:2-29.4(a)4i – Lines of insurance written by each affiliate;

4. N.J.A.C. 11:2-29.4(a)4v – Agency relationships of affiliates by agent name, to the extent available through the Department's licensing system;

5. N.J.A.C. 11:2-29.4(a)5 – Premium volume, number of current policyholders, market share and number of producers by line of business;

6. N.J.A.C. 11:2-29.4(a)6 – Address of applicant's offices in this State;

7. N.J.A.C. 11:2-29.4(a)7 – Policyholder nonrenewal and producer termination notices;

8. N.J.A.C. 11:2-29.4(a)9 – Name and address of each insurance producer to the extent available through the Department's licensing system;

9. N.J.A.C. 11:2-29.4(a)11 – Copies of all correspondence and notices sent to various entities, as approved, to which the applicant owes a financial obligation;

10. N.J.A.C. 11:2-29.4(a)12 – Certified statement of New Jersey incurred liabilities and reserves;

11. N.J.A.C. 11:2-29.4(a)14 – Deposits held by a custodian on behalf of the Commissioner; and

12. N.J.A.C. 11:2-29.4(a)17 – Establishment of special deposits or equivalent performance bonds as approved.

11:2-29.7 Fines and penalties

Failure to comply with this subchapter may result in the imposition of sanctions by the Department including, but not limited to, sanctions pursuant to N.J.S.A. 17:33-2.

11:2-29.8 Severability

If any provision of this subchapter or its application to any person or circumstance is held invalid, such determination shall not affect other provisions or applications of this subchapter which can be given effect without the invalid provision or application, and to that end the provisions of this subchapter are separable.

APPENDIX 16

ORDER NO.: A91-279

STATE OF NEW JERSEY
DEPARTMENT OF INSURANCE

IN THE MATTER OF:	ADMINISTRATIVE ACTION
ALLSTATE INSURANCE COMPANY PRIVATE PASSENGER AUTOMOBILE RATE FILING (APPLICATION FOR INTERIM RATE RELIEF)	Agency Docket Nos.: 90-1044 & 90-1320 OAL Docket No.: INS-565-915 DECISION AND ORDER

This matter comes before the New Jersey Commissioner of Insurance (Commissioner) pursuant to the provisions of *N.J.S.A.* 17:29A-1 et seq., *N.J.S.A.* 17:1C-6 and *N.J.S.A.* 52:14B-1 et seq. and all powers expressed or implied therein.

Procedural History

On August 24, 1990, Allstate Insurance Company (Allstate) filed for approval of a private passenger automobile rate change seeking an overall statewide rate level increase of 8.6 percent. This proposed increase seeks to include in the base premiums the surtax and assessments incurred under the Fair Automobile Insurance Reform Act of 1990, P.L. 1990, c.8 (FAIR Act). In its transmittal letter, Allstate requested that if the rates were not approved within 30 days, then the Commissioner should

convene a hearing to consider the merits of the application. By letter dated September 28, 1990 Allstate reiterated its request for a hearing. After further correspondence between Allstate and the Department of Insurance (Department) concerning the completeness of the filing, Allstate commenced an action in the Superior Court, Chancery Division, which resulted in an Order dated December 20, 1990 which found the filing to be complete and directed that the matter be transferred to the Office of Administrative Law (OAL) for hearing. The matter was so transmitted on January 4, 1991.

On October 16, 1990 Allstate filed for approval of a private passenger automobile rate change seeking an overall statewide rate level increase of 27.7 percent independent of the surtaxes and assessments imposed by the FAIR Act. Allstate again requested a hearing on the filing if the rate increase was not approved within 30 days. This second matter was transferred to the OAL for hearing on November 30, 1990.

The Division of Rate Counsel, Office of the Public Advocate (Public Advocate) has intervened in both matters. Hearings before the assigned Administrative Law Judge (ALJ) commenced February 6, 1991 and have continued to date.

On January 17, 1991 Allstate filed separate applications in both of these proceedings seeking emergent, interim rate relief. Department staff and the Public Advocate filed letter briefs opposing the applications on January 28 and January 24, respectively.

Contentions of the Parties

Allstate requests that it be permitted to implement its proposed rate increases, as filed, on an interim basis pending final decision upon completion of the hearings. The increase would be refunded should Allstate not prevail. Allstate asserts that payment of the FAIR Act surtaxes and assessments caused it to lose $26.4 million in 1990 and that its losses are continuing at the rate of over $69,000 each day. Since new rates fixed as a result of the pending proceedings may only be applied prospectively, these current losses will never be recoverable. Allstate thus asserts that it is sustaining irreparable harm which entitles it to interim rate relief pursuant to the Uniform Rules of Administrative Procedure, *N.J.A.C.* 1:1-12.2. Allstate asserts that the Commissioner's general statutory powers under *N.J.S.A.* 17:1-1 and 17:1-2 (see also *N.J.S.A.* 17:1C-6) authorize him to approve interim rates on an emergency basis, which authority has been recognized in appropriate circumstances. *N.J. State AFL-CIO v. Bryant*, 55 171 (1969); *N.J. Land Title Insurance Rating Bureau v. Sheeran*, 151 *N.J. Super.* 45 (App. Div. 1977).

In opposition to Allstate's interim rate application, the Department's staff contends that the Legislature, in *N.J.S.A.* 17:29A-14e, has delineated the limited circumstances in which the Commissioner may grant rate relief and by such delineation has implicitly prohibited any other use of interim rates. Department staff argues that *N.J.S.A.* 17:29A-14e sets forth certain circumstances in which the Commissioner may set interim rates prior to a hearing and that such delineation must be read as evidence that the Legislature did not intend for interim rates

to be set in other circumstances. In support of this argument staff cites a general principal of statutory construction which holds that where a manner of performance is statutorily designated there is an inference that all omissions are exclusions. 2A Sutherland *Statutory Construction* Section 47.23: *Shapiro v. Essex County Freeholder Board* 177 *N.J. Super.* 87 (Law Div. 1980) Staff also notes that in *N.J. State AFL-CIO v. Bryant*, 55 *N.J.* 171 (1969), which was cited by Allstate as support for the Commissioner's implied authority to set interim rates, no statutory mandate for a prior rate hearing existed; whereas here a prior hearing is required pursuant to *N.J.S.A.* 17:29A-14. Alternatively, Department staff asserts that even if interim ratemaking authority does exist, Allstate has failed to meet its burden of justifying rate relief prior to the conclusion of the pending permanent rate cases.

The Division of Rate Counsel, Department of the Public Advocate (Public Advocate), similarly opposes Allstate's interim applications on the ground that the Commissioner lacks authority to grant them and, alternatively, that Allstate has failed to show its entitlement to such relief. The Public Advocate contends that the cases relied upon by Allstate do not support its application, and that approval of interim rates would subvert the regulatory scheme.

Decision

N.J.S.A. 17:29A-14 addresses the alteration of rates by personal lines of property and casualty insurers. Paragraph a of that statute provides that insurers may alter or amend their rates and rating systems only with the prior

approval of the Commissioner. Paragraph c then provides as follows:

> c. If an insurer or rating organization files a proposed alteration, supplement or amendment to its rating system, or any part thereof, which would result in a change in rates, the commissioner may, or upon the request of the filer or the Public Advocate shall, certify the matter for a hearing. The hearing shall, at the commissioner's discretion, be conducted by himself, by a person appointed by the commissioner . . . or by the Office of Administrative Law . . . as a contested case. . . .

Thus the Legislature has provided that rate changes such as those proposed by Allstate may not be implemented without prior approval of the Commissioner after an opportunity for a hearing, if requested by the filer or the Public Advocate, or otherwise determined to be necessary by the Commissioner in the absence of a request from either. In both present matters Allstate itself requested hearings.

Allstate's applications squarely present the question whether the Commissioner has authority to approve an interim rate increase for a personal lines property-casualty insurer when a hearing on the proposed rate change has been requested and is pending. For the reasons set forth below, I find that the Commissioner does not have such authority, and am therefore constrained to dismiss both applications. I further find that even if such authority did exist, however, I would not choose to exercise it for reasons set forth below.

Allstate asserts that it is entitled to an interim rate increase because it is suffering irreparable harm, citing *N.J.A.C.* 1:1-12.6(a). While that rule provides jurisdiction to grant emergency relief "{w}here authorized by law and where irreparable harm will result . . . ", reliance upon it to provide independent authority in the Commissioner to approve a rate change prior to the conclusion of a requested hearing is misplaced, since it merely begs the question whether such an action is authorized by law.

In other contexts the general powers of the Commissioner under N.J.S.A. 17:1-1 et seq. have been found in two cases to include the authority to approve rates on an interim basis. Nevertheless, as the discussion below concludes, neither of those cases provides support for authority to act in the present matter.

In *N.J. State AFL-CIO v. Bryant*, 55 *N.J.* 171 (1969), the Supreme Court affirmed the Commissioner's decision to approve increased rates for an applicant that was in serious financial distress pending a final determination on its application for permanent new rates. In a hearing commenced but not concluded, evidence showed that the applicant, Blue Cross, had a substantial and growing deficit; was technically insolvent; and was operating without required minimum reserves. 55 *N.J.* at 174. The parties to the hearing, including counsel appointed to represent the public interest, acknowledged that an immediate rate increase was required simply to stabilize Blue Cross's deficit at the existing level pending a final decision. The rates approved were the minimum required to do so and to which all parties agreed. The Court noted that the statutes applicable to Hospital Service Corporation rate changes, N.J.S.A. 17:48-6.5 and 17:48-9, neither

required the express prior approval of rates nor mandated that a hearing be held. Under such circumstances, the Court concluded:

> "There is no provision in the statute barring an interim rate increase pending completion of a hearing as to the adequacy or inadequacy of either existing or proposed rates. *In the absence of an express prohibition,* the broad language of the authority conferred on the Commissioner ought to be deemed by implication to carry power for interim relief." 55 *N.J.* at 176 (emphasis added).

Similarly, in *N.J. Land Title Insurance Rating Bureau v. Sheeran,* 151 *N.J. Super.* 45 (Law Div. 1977), the Commissioner was required to approve new, initial rates for title insurance under a newly enacted regulatory scheme. As of the statutory deadline for approval of the new rates, the hearing had not concluded. Failure to approve rates for title insurance would have seriously disrupted the market for the transfer of real estate. All parties at the hearing agreed that a rate must be established; the applicant asserted that the temporary rates should be those higher rates set forth in its filing, while the Public Advocate argued that the pre-existing, lower rates should continue to be used. The Commissioner directed continued use of the pre-existing rates during the hearing process. In upholding this exercise of authority by the Commissioner, the court stated:

> "We, moreover, regard it as both essential and well settled that the scope of the Commissioner's broad administrative powers conferred by *N.J.S.A.* 17:1-1, 2 must be construed to

> include interim rate making *not expressly proscribed by the statute. N.J. State AFL-CIO v. Bryant*, 55 *N.J.* 171, 176 (1969)." 151 *N.J. Super.* at 53 (emphasis added).

The Court then found that no express provision of the Title Insurance Law prohibited the action challenged, which was determined to be an emergent and transitional fixing of rates, not rate structuring under the Act.

The emphasized language in both of the cases set forth above indicates to me that the Commissioner's implied or general power to fix interim rates cannot supersede express direction from the Legislature to approve a rate change only after hearing, if one is requested. *N.J.S.A.* 17:29A-14c specifically provides that: "The Commissioner . . . upon the request of the filer or the Public Advocate, *shall* certify the matter for a hearing." (Emphasis added). I find that this specific requirement of the ratemaking statute applicable to these proceedings precludes granting the relief requested here. Although Allstate asserts that the authority to approve interim rates is not specifically prohibited, the Legislature need not both mandate that an act be done, and forbid the failure to do it, in order to convey its intent to executive officers.

This construction of the ratemaking statute is buttressed by the specific authority granted in *N.J.S.A.* 17:29A-14e to set initial rates for certain optional coverages on an interim basis, subject to hearing and subsequent adjustment. I recognize that the principal of statutory construction relied upon by staff in construing *N.J.S.A.* 17:29A-17e as an absolute prohibition against any

form of interim ratemaking has been held to be inapplicable "where there is some special reasons for mentioning one thing and none for mentioning another which is otherwise within the statute." 2A Sutherland *Statutory Construction* Section 47.23 at p. 194. In enacting *N.J.S.A.* 17:29A-14e, the Legislature specifically addressed the optional automobile insurance coverages, and while this provision should not be read, in itself, as a prohibition against interim ratemaking authority, I interpret it in conjunction with N.J.S.A. 17:29A-14c as expressing an assumption by the Legislature that a hearing is required when requested.

The mandate in *N.J.A.C.* 17:29A-14c for a contested case hearing when requested prior to changes in personal lines property-casualty insurance rates may be contrasted with the statutory scheme for adjustment of public utility rates by the Board of Public Utility Commissioners (Board). *N.J.S.A.* 48:2-21(b) provides that: "The board may after hearing, upon notice, by Order in writing . . . [f]ix just and reasonable individual rates, joint rates, tolls, charges or schedules. . . . " *N.J.S.A.* 48:2-21.1 then provides, however, that the Board may by agreement with the public utility adjust the rates during the pendency of the hearing. Thus despite the hearing requirement, the Board is specifically empowered by the Legislature to grant interim rate changes. No comparable authority is provided to the Commissioner of Insurance in matters coming before him pursuant to *N.J.S.A.* 17:29A-14.

Moreover, it must be noted that the Legislature has recently established an alternate remedy to an increase in rates when an insurer is faced with financial hardship as

Allstate complains of here. Sections 95 through 99 of the FAIR Act (*N.J.S.A.* 17:33B-52 through 17:33B-56) provide relief when an insurer's financial condition will become unsafe or unsound if the insurer is required to comply with various duties required under that Act. True hardship, which could be considered "irreparable harm", can follow if an insurer's financial condition is unsafe or unsound, because the result can be a declaration of insolvency, appointment of a receiver or a decreased rating from one of the major rating agencies, any of which is irretrievably adverse to an insurer's market reputation and thus its ability to attract both investors and insurance business. Those statutes provide that in such circumstances the insurer may apply to the Commissioner for an exemption, abatement or deferral of the surtax, assessments and other obligations. Many insurers have done so and the Commissioner has, when appropriate, granted this form of relief.

Even if the Commissioner did have the power pursuant to N.J.S.A. 17:29A-14 to approve an interim rate increase when a hearing has been requested, I find that such authority should not be used under the circumstances presented here. New Jersey's courts have long recognized that assuming the power to grant interim relief requires a most sensitive exercise of discretion. When confronted with extraordinary circumstances that may call for the exercise of that discretion, our judiciary has been guided traditionally by certain fundamental principles. Those principles are set forth in *Crowe v. DeGioia*, 90 *N.J.* 126, 132-34 (1982) to require the following:

(1) Irreparable harm;

(2) Uncontroverted material facts, *i.e.*, a reasonable probability that the applicant will ultimately succeed on the factual merits; and

(3) Settled law, *i.e.*, a reasonable probability that the applicant will ultimately prevail on the legal merits;

(4) A showing that the relative hardship to the applicant if relief is denied is disproportionately greater than the hardship to the applicant if the relief requested is granted. An examination of these principles in the context of the present case clearly demonstrates that interim rate relief is inappropriate in matters such as this one.

As noted in the case law applying the standard for injunctive relief, "[h]arm is generally considered irreparable in equity if it cannot be redressed adequately by monetary damages." *Crowe v. DeGioia*, 90 *N.J.* 126, 132-33. In ratemaking situations the New Jersey Supreme Court has recognized that some money will necessarily be irretrievably lost during the administration of the procedures required to change regulated rates. *Helmsley v. Borough of Fort Lee*, 78 *N.J.* 200 (1978); *In Re: New Jersey Power and Light Co.*, 15 *N.J.* 82 (1954). Since *N.J.S.A.* 17:29A-14 nevertheless requires a hearing if requested prior to an order by the Commissioner approving a rate change (except under the "flex rating" provisions; see *N.J.S.A.* 17:29A-44), both the Court and Legislature have determined that the loss of revenue of which Allstate complains is not "irreparable harm".

Secondly, interim relief must be based on material facts to which there is no bona fide dispute, so that the decision maker may be reasonably confident that the applicant will ultimately succeed on the factual merits. One can hardly imagine a matter in which there is more dispute concerning the material facts than the present one, which at this writing has consumed 40 days of hearings and is still continuing. While Allstate's brief recites certain facts concerning the procedural history of its filings, the facts material to a determination of this matter are those that address the substance of its rate change request.

Thirdly, interlocutory relief requires settled law, likewise to provide the decision maker with reasonable confidence that the applicant will ultimately prevail on the legal merits. The legal issues at the hearing, which include various asserted alternatives to the Department's standard ratemaking methodology set forth in *N.J.A.C.* 11:3-16.10, are likewise vigorously disputed.

Finally, a case for interim relief requires a balancing of the relative hardship to the parties. The Legislature has, I believe, struck that balance by precluding approval of a rate increase before a requested hearing is held. It is appropriate that they have done so, particularly when the subject involves a mandatory purchase of insurance. This is the case with private passenger automobile insurance which is required by statute to be maintained as a condition of owning and operating a vehicle. *N.J.S.A.* 39:6A-1. It should be noted that the statutory requirement for a hearing in automobile insurance rate increase requests was added to the ratemaking statute in 1983 (P.L. 1983, c. 65) after the decision in *N.J. State AFL-CIO v. Bryant*,

supra, and *N.J. Land Title Insurance Rating Bureau v. Sheeran, supra*, and after the creation of the Public Advocate with its duty "to represent and protect the public interest" in ratemaking. (P.L. 1974, c.27; *N.J.S.A.* 52:27E-18). The public who must purchase insurance has been provided with both a right to a hearing on changes in the rates they must pay, and the Public Advocate to represent them at the hearing. To approve an interim rate increase would serve to deprive the public of its right to a hearing by which its interests are determined, and would be inconsistent with the nature of contested case proceedings.

Furthermore, in balancing the relative hardship to the parties, I note that *N.J.S.A.* 17:29A-44 permits automobile insurers to increase their rates each year by a percentage tied to the consumer price indices. These automatic, annual increases may mitigate any financial hardship to rate increase filers during the hearing and decision procedures. * In sum, interim rate relief would never be appropriate in cases such as this one, where a private passenger automobile insurer seeks an increase in rates, and a hearing has been requested and is being vigorously controverted.

In the present matter, Allstate has asserted its entitlement to approval of an interim rate increase because of the alleged harm it is sustaining as a result of its payment of the FAIR Act surtaxes and assessments. As noted above, Allstate has an alternate remedy available in that it may apply for exemption, abatement or deferral of

---

* Allstate implemented a 6.46% "flex rate" increase on July 1, 1990 and has filed to implement a further 7.03% "flex rate" increase on July 1, 1991.

those obligations in accordance with *N.J.S.A.* 17:33B-52 et seq., should it qualify to do so. Under these circumstances, the application to approve increased rates pending final determination in the proceedings now underway must be denied.

Now, therefore,

IT IS on this 28th day of June, 1991

ORDERED that the pending petitions of Allstate Insurance Company for interim rate increases be, and hereby are, dismissed.

June 28, 1991
Date

/s/ Samuel F. Fortunato
Samuel F. Fortunato
Commissioner

DB41/ORDERS